

CONTENTS

Page

INTRODUCTION

The Theory of Economic Development in General Perspective

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FACULTY OF ARTS

DEPARTMENT OF POLITICAL ECONOMY

1. Economic Theory and Practical Policy	1
2. Self-imposed Limitations upon Economic Theory	2
3. External Limitations upon Economic Investigation	7
4. The Synthesis of Economic Theory	8
5. The Formal Treatment of the Theory of Economic Development	14
6. The New Treatment of the Theory of Economic Development	23
7. Subject and Plan of the Work	40

PART I

Thesis prepared for the Degree of Ph.D.,
under the supervision of
Professor Sir Alexander Gray and Dr. L.C. Wright.

Chapter 1. The Theory of Economic Policy
in Pre-Classical Thought.

1. The Mercantilists	42
2. The Physiocrats	52

Chapter 2. The Theory of Economic Policy

"Studies in the Theories of Economic Development
with Special Reference to (a) The Circumstances
Under Which Economic Progress Obtains, and (b)
Policies Which Promote Progress."

57
74

Chapter 3. Population Theory in Classical

By

H. OMAR,
M.A.Com. Manchester.

82
109

Chapter 4. The Classical and Pre-Classical

Theories in Relation to the
Over-Developed Economy.

111



CONTENTS

	<u>Page</u>
<u>More Recent Trends in the Theory of Economic Development</u>	
<u>Chapter 3. Economic Policy in the Marxian Scheme.</u>	127
<u>INTRODUCTORY</u>	
<u>The Theory of Economic Development in General Perspective</u>	132
1. Economic Theory and Practical Policy	1
2. Self-imposed Limitations of Economic Theory	2
3. External Limitations upon Economic Investigation	7
4. The Synthesis of Social Sciences	8
5. The Formal Treatment of the Theory of Economic Development	14
6. The New Treatment of the Theory of Economic Development	28
7. Subject and Plan of the Work	40
<u>PART I</u>	
<u>The Theory of Economic Development in Classical and Pre-Classical Political Economy</u>	
<u>Chapter 1. The Theory of Economic Policy in Pre-Classical Thought.</u>	
1. The Mercantilists	42
2. The Physiocrats	52
<u>Chapter 2. The Theory of Economic Policy in Classical Political Economy.</u>	
1. Adam Smith	57
2. John Stuart Mill	74
<u>Chapter 3. Population Theories in Classical Political Economy.</u>	
1. Thomas Robert Malthus	82
2. David Ricardo	105
<u>Chapter 4. The Classical and Pre-Classical Theories in Relation to the Under-Developed Economy.</u>	110

PART IIMore Recent Trends in the Theory of Economic Development

<u>Chapter 5.</u>	Economic Destiny in the Marxian Scheme.	127
	1. Falling Rate of Profit	132
	2. The Accumulation of Capital	139
	3. The Periodical Occurrence of Acute Crises	141
<u>Chapter 10.</u>	4. Increasing Misery of Proletariat	142
	5. Breakdown of Capitalism	147
<u>Chapter 6.</u>	The Clash Between Security and Material Progress.	157
<u>Chapter 11.</u>	The State and the Ruling Class	160
	1. Economic Progress and Social Security	160
	2. Are Trade Unions Obstructive?	173
<u>Chapter 7.</u>	Secular Stagnation in the New Economics.	197
	(a) On the Saving Side	200
	(b) On the Investment Side	204
	1. Decline in Population Growth	205
	2. Passing of The Frontier	210
	3. Dearth of Great New Industries	213
<u>Chapter 13.</u>	The Economic Significance of the Family	218
<u>Chapter 8.</u>	The Modern Theory in Relation to the Under-Developed Economy.	218
	1. The Meaning of Stagnation in Mature and Immature Economies	223
	2. Stagnation Thesis from the Viewpoint of the Under-Developed Economy	226
	3. Barriers to Progress in connection with the Under-Developed Economy	228
<u>Chapter 14.</u>	4. The Marxian Scheme in relation to the Under-Developed Economy	232

PART III

The Circumstances under which Economic Progress Obtains

<u>Chapter 9.</u>	Evolution of Simple Communities	235
<u>Chapter 10.</u>	The Demographic Aspects of Economic Progress	
1.	The Early Settlement	235
2.	The Slave Economy	240
3.	The Primitive Peasant Economy	256
<u>Chapter 10.</u>	The Agents of Economic Progress	260
1.	The Theory of the Creative Minority	262
2.	The Role of the Foreigner	265
<u>Chapter 11.</u>	The State and the Ruling Class	271
<u>Chapter 12.</u>	Investment Incentives: Advertising	
1.	The Concept of the State	271
2.	The Concept of The Ruling Class	274
<u>Chapter 12.</u>	Religion and Economics	282
1.	Economic Ethics in Christian Philosophy	282
2.	Economic Ethics in Islamic Philosophy	290
<u>Chapter 13.</u>	The Economic Significance of the Family	297
1.	The Family as a Social Unit	297
2.	The Property Institution	300
3.	Land Ownership	303
4.	Incidence of Land Ownership	313
<u>Chapter 13.</u>	The Size of the Agricultural Unit	316
5.	Agricultural Systems	317
6.	The System of Inheritance	321
<u>Chapter 14.</u>	Some Other Aspects of Economic Progress	323
1.	Biological and Geographical Aspects	323
2.	Psychological Aspects	325
3.	Engines of Economic Progress	327
4.	Summary and Prospects	329

<u>Chapter 15.</u>	Entrepreneurial Incentives: The Efficiency Problem	
1.	The Problem of a Competitive Market	421
2.	The Patent System and Economic Development	424
3.	Co-operative Industrial Research	433
4.	The Technological Problem in Perspective	439
5.	The Human Factor in Industrial Efficiency	445

PART IV
Policies which Promote Progress

<u>Chapter 15.</u>	The Demographic Aspects of Economic Development.	331
1.	The 'Static' Problem of Population in Under-Developed Societies	332
2.	The 'Dynamic' Problem of Population in Under-Developed Societies	337
3.	Development or No Development	343
<u>Chapter 16.</u>	Investment Incentives: Advertising and Demand.	346
1.	The 'Income' Concept in relation to the Under-Developed Economy	347
2.	The Vicious Circle of Poverty	353
3.	The Lack of Purchasing Power in Real Terms	355
4.	Advertising Policies	359
<u>Chapter 17.</u>	Investment Incentives: The Size of The Market and the Theory of Balanced Growth.	367
1.	The Theory of Balanced Growth	368
2.	State Planning	374
<u>Chapter 18.</u>	Entrepreneurial Incentives: Legal and Administrative Policies	380
1.	The Legal Framework and Enterprise	380
2.	Foreign Entrepreneurship	389
3.	The Element of Risk	397
4.	The Time Factor	401
5.	Inconsistency of Money Wages with Real Costs of Labour	406
6.	Entrepreneurial Efficiency	409
<u>Chapter 19.</u>	Entrepreneurial Incentives: The Efficiency Problem.	418
1.	The Meaning of a Competitive Policy	418
2.	The Patent System and Economic Development	424
3.	Co-operative Industrial Research	433
4.	The Technological Problem in Perspective	437
5.	The Human Factor in Industrial Efficiency	446

	<u>Page</u>
<u>Chapter 20.</u> Saving Incentives.	453
1. Concealed Saving Potential	454
2. Saving Incentives: Institutions, Inflation and Taxation	459
3. Savings and The Demonstration Effect	468
<u>Chapter 21.</u> The Supply of Capital.	476
1. Domestic Sources of Capital	477
2. Public Lending Agencies:	482
(a) Farm Credit Institutions	483
(b) Industrial Development Banks	489
3. External Sources of Capital:	492
(a) Private Investment	496
(b) Governmental Lending	499
(c) Inter-Governmental Grants	503
<u>Chapter 22.</u> Are Some Types of Economic Activity More Important than Others?	512
1. The Four Propositions	512
2. Industrialisation or Agricultural Development?	513
3. Selection of Industries	519
<u>Chapter 23.</u> Planning in Practice	523
Statistical Appendix	527
Bibliography	528

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THE CHANGING OF ECONOMIC DEVELOPMENT

IN GENERAL PERSPECTIVE

1. ECONOMIC THEORY AND PRACTICAL POLICY.

One of the most significant facts of modern life in almost all civilised communities is the ever-widening range of state action, and as this spreads the more complex become the problems of policy formulation and administration. In the selection of objectives as well as methods, the statesman needs all the help he can get from specialists in every field of human life. And, as so many problems of government lie within the scope of economics, the economist is increasingly prominent among those specialists whose aid is sought.

The chief intent of **INTRODUCTORY** studies and the justification of specialising in this field, have always been found in the hope that they will contribute to the solution of concrete problems.

The value of economic science in **GENERAL PERSPECTIVE** the public and most students of economic science derives from the belief in the practical utility of the specialised knowledge of the economist, in the relevance of the main body of economic doctrine to policy-making. This belief is readily recognisable without questioning. What is questionable may, in fact, be the quality of the economist's performance and the accuracy of his fact finding. Either or both are often the subjects of bitter criticism. In times such as these the advice of the economist is given, because 'practical men' in business or in government find themselves helplessly confronted with problems which reach beyond their own experience. His advice, however, is still in some measure suspect.

1. ECONOMIC THEORY AND PRACTICAL POLICY.

One of the most significant facts of modern life in almost all civilised communities is the ever-widening range of state action, and as this spreads the more complex become the problems of policy formulation and administration. In the selection of objectives as well as methods, the statesman needs all the help he can get from specialists in every field of human life. And, as so many problems of government lie within the scope of economics, the economist is increasingly prominent among those specialists whose aid is sought.

The chief incentive to economic studies and the justification of specialising in this field, have always been found in the hope that they will contribute to the solution of concrete problems. The value of economics in the eyes of the public and most students of economic science derives from the belief in the practical utility of the specialised knowledge of the economist, in the relevance of the main body of economic doctrine to policy-making. This belief is readily recognisable without questioning. What is questionable may, in fact, be the quality of the economist's performance and the accuracy of his fact finding. Either or both are often the subject of bitter criticism. Yet time and again the advice of the economist is sought, because 'practical men' in business or in government find themselves helpless when they face problems which reach beyond their own experience. This advice, however, is still in some measure suspect as being too

theoretical or academic, too lacking in practical judgment. While anxious to prove the value of his professional skill, the economist himself is fully aware of the limitations of economic science, of the gulf between economic theory of all schools and the process of policy-making.

It is important at the outset to survey the limitations of economic theory in relation to practical policy, for the attempt is worth while if we should seek to reconstruct theory in a more useful and realistic form. If it is found that the application of theory to the concrete problems of real life requires co-operation with other scientists and specialists in other fields, then that co-operation should be established and perpetuated. These issues are of much interest for the philosophy of science or methodology; but they are also of practical importance because the practical man is very often confronted with policy problems beyond the competence of his unaided common sense.

2. SELF-IMPOSED LIMITATIONS OF ECONOMIC THEORY.

The gulf between economic theory and practical policy is partly due to the great complexity of the practical problems with which policy is concerned and the prevalence of obstacles to the use of scientific method. Of all branches of science none is devoid of its own external limitations of such a kind. But there also exist limitations which economists, conscious of the

independent status of their science, have imposed upon themselves by their definition of the scope and method of economics. In the last hundred years the tendency has been to draw these self-imposed boundaries closer and closer in an attempt to delimit a field within which the findings of economics would be as incontestable as those of other recognised natural sciences. The political economy of the last two centuries mixed abstract reasoning with description of existing conditions, speculation about the future and discussion of ethical principles and political expediency. In an attempt to achieve positivity, objectivity and certainty in theorising, and to win for economics a place among the sciences, later writers have shed much of the ethical, technological and sociological content of the older political economy, and have made much of the distinction between the explanation of things as they are and the prescription of how they should be. Taking the former task as their province, most modern economists deny the competence of their science to formulate ends or objectives. Within its own restricted field, the positive findings of economics are supposed to form the instrumental knowledge that may guide the choice of means to achieve a given objective, once that objective has been independently established as socially desirable. Only in this way, it is sometimes argued, can economics contribute to the success of policy.

(1) A survey of the literature of modern economics, however,

reveals that exclusion of the normative viewpoint is incomplete. In Marshallian and Pigovian 'Welfare Economics', ethical questions are openly raised and solutions proposed. Even quite recently Little contends that welfare economics as a branch of economic science can hardly be a positive study to be based exclusively on objective principles. The complications and contradictions which Scitovsky has shown to be implicit in the Kaldor-Hicks welfare criterion for any economic change has led Little to believe that the avoidance of such contradictions can only be effected through the introduction of moral premisses and value judgments in order to arrive at unambiguous welfare conclusions. (1)

The attempt to establish a positive economic science, however, has been, if not wholly successful, at any rate worth while. For it has permitted a greater concentration upon the mere explanation of price formation and of market operations as well as a clearer understanding of causal relationships between economic variables. It may be contended, after all, that there has been no scarcity of ethical teaching of a general character while there have been many fallacious conceptions as to how the economic system does actually work.

Thus if modern economic literature be considered as a guide to the subject matter of economic science, we can readily recognise two extremes. At one extreme, the abstract theorists, whose position and attitude has been defined and defended by Professor

(1) I.M.D. Little, Critique of Welfare Economics, Oxford, 1950.

L. Robbins, maintain that economics is in no way connected with the explanation of techniques or institutions but takes these, along with the wants and the physical and moral resources of the society concerned, as the data of economic theory. Given all the data, the economic problem, from the standpoint of this school of thought, is merely the allocation of available scarce resources as between alternative uses according to some principle; and economic analysis is just an attempt to discover this principle and to exhibit the transactions by which it is made effective. This principle is often referred to in economic literature as the principle of maximisation, or minimisation, or optimisation of some or other economic magnitude, e.g., utility or disutility, profit or revenue, cost or output. But the abstract theorists would encounter some difficulty in agreeing as to what is to be maximised, minimised, or optimised without recourse to ethics, technology and sociology.

At the other extreme, the so-called institutionalists, in an attempt to provide a comprehensive picture of economic behaviour in general terms, give to techniques and institutions the same status as they give to theory. Between these two extremes are placed the majority of economists who have found it impossible to avoid mixing some description of wants, techniques and institutions with logical deduction, formal argument and abstract theory. Nevertheless, the attempt is made to demarcate between the pure theory of the market and the description of practice. Surveys of

human wants, techniques of production, and social institutions are becoming more and more the exception in economic literature. These matters are increasingly relegated to other allied subjects which the appropriate specialists undertake to study and explain, while the economic theorist follows up his own speciality. This specialisation, no doubt, has facilitated progress in the exploration of the problems of market equilibrium under various assumed conditions, but the resultant body of economic doctrine is inevitably remote from the possibility of practical application. To this extent, the gap between theory and policy is of the economist's own making. If creation of this gulf was necessary for the progress of economic theorising, bridging it is equally necessary for the application of theory to policy.

The abstract theorists, no doubt, have sought to define economic theory in such a manner as to exclude the study of institutions and techniques. All these variables are grouped among the given factors influencing the relative scarcity of different economic goods, while economic theory studies only the principles by which these scarce goods are allocated between alternative uses. Now what is given cannot be at the same time the subject of study. The adoption of this definition imposes a limitation upon the economist's field of investigation and discourages any effort on his part to study scientifically the way in which these given factors develop. Since changes in wants, techniques and institutions are dominant causes of that complexity

in economic problems which drives the practical man to seek the aid of the economist, such a restricted definition of the scope of economic science tends to widen the gap between economic theory and practical policy. on the other hand, stand in the way of setting down hitherto unrecorded facts, and prevent publication of material which particular individuals have already prepared for their own purposes. Here, too, the economic investigator is at

3. EXTERNAL LIMITATIONS UPON ECONOMIC INVESTIGATION.

The pure theorist can work in his study; he needs neither laboratory nor field of work, as long as he confines himself to working at the logical implications of a given set of conditions relating to the scarcity of available resources. As Wieser argued, "we can observe natural phenomena only from the outside but ourselves from within." This obviously makes the social sciences essentially different from the natural sciences. But if the economist takes wants, technology and social institutions as part of his subject matter, his material is scattered throughout the world. Some of it may reach him in the form of figures, statistics and descriptive literature, and may therefore be available for investigation within four walls. But there will always be gaps and imperfections in the material available to the academic investigator, and even to the economic adviser in the service of the state. Many of the facts which are necessary for a complete picture are not recorded at all; others are recorded but secretly. Of those that are not recorded some could be recorded through special investigations. No doubt the amount of new factual

material made available in recent years is substantial at least in the more advanced communities in Western Europe and America, but the cost is a limiting factor to any such factual research. Obstacles of privacy, on the other hand, stand in the way of setting down hitherto unrecorded facts, and prevent publication of material which particular individuals have already prepared for their own purposes. Here, too, the economic investigator is at still greater disadvantage as compared with the natural scientist; for even apart from the denial of access to facts, the publication of which might affect particular interests, there is always the danger that personal or class bias will limit the economist's interest in certain facts and thereby discourage their investigation. This danger will form another limitation upon the factual material which is accessible to the most disinterested economist. Furthermore, there is the tendency of factual material to be out of date as soon as it has been recorded. This deficiency in factual knowledge has often been emphasised with reference to quantitative studies, for the relevant variables are actually subject to frequent changes of varying magnitudes and duration.

4. THE SYNTHESIS OF SOCIAL SCIENCES.

If then the tendency among economists has traditionally been to attempt to shed ethics, technology and sociology in order to concentrate on a narrower range of problems involving the behaviour

of the 'economic man' in the sense with which students of economics are familiar, it may be worth while to consider whether a synthesis of social sciences would bring the complex problems of human behaviour nearer to a more satisfactory solution.

Final Economics is sometimes defined as a science of human motives; and by definition it is possible to simplify the economic problem by disregarding all motives except the prospect of gain. The market structure will measure out wealth to all individuals; each in proportion to what has been earned by his efforts or by the use of his property. Each will be led to put his efforts and his property to the most remunerative use. It is true that such a simplification is useful in economic analysis, provided it is recognised to be an abstraction. In real life, however, there are alongside the motive of gain other motives which are really difficult to analyse or measure. A great deal of the daily work is done in response not to the incentive of gain, but to the such deeply ingrained obligations of the family. Analogous to the obligations of the family in their detachment from gain are the obligations of the individual to the State, and the reciprocal obligations of the State to the individual. In civilised communities the rational basis of the State is everything; it is an instrument of security, and of law and order, and also of the promotion of welfare in its various aspects. "The State," says Hawtrey, "like the family, is the embodiment of a code of motives. Its function is to influence conduct. But it exerts its influence

along three discrepant channels. To those who identify themselves with it, it is a wider family, claiming allegiance and conferring benefits. To those within its jurisdiction it is a ruler imposing its will by compulsion and threat of force. Finally to all concerned it is a rationally constituted instrument of organised action, to be controlled, regulated and directed as expediency may indicate, and to be valued and supported in proportion to its usefulness."⁽¹⁾

Economics, politics and other fields of social study in fact explain different aspects of human conduct and motives. In real life, the applied economist, who attempts to solve a concrete problem, is bound to transcend the traditional boundaries of the economic science; and such an attempt should evidently take him far into the realm of sociology; or, at least, he must be prepared to draw heavily on the work of the sociologist. In point of fact, sociologists have launched their investigation into such topics as politics, religion, family, property and other social institutions. But whereas economists have hitherto written very little about these topics, sociologists, on their part, have written very little about the economic aspects of these topics in their special field of study. Thus a gap is to be bridged and a synthesis of the social sciences achieved. True, the splitting of social study into specialised watertight compartments might be of great value in the advancement of social sciences. Specialisation

(1) R.G. Hawtrey, *Economic Aspects of Sovereignty*, 2nd Edition, London, 1952, p.32.

in the field of scientific study, as a whole, has its own merits for diminishing returns might operate here as effectively as in the field of industry. Still, of all the social sciences that suffered from splitting it was the science of economics which suffered most. If we take away from it what history and sociology may be taken, we are left over with no more than pure abstractions with few assumptions and postulates. This is what really took place. Economics has substantially become more and more an exercise in logic or, more recently, mathematical logic. It may thus be said with some justification that, with such development, the science has become of a purely academic interest designed for the high intellectuals, but not for the common reader.

Now granted that the economist, the technician and the sociologist all have much to their credit in their respective fields of study, and that each may contribute his share to the progress of science and participate in revealing the truths of social life, there still remains the problem of synthesis. It would be futile for all the specialists to advise severally on the various aspects of a problem to the practical man, leaving him with the formidable task of effecting a synthesis. In real life, we can scarcely find a practical man who might be capable of performing this task. In real life, too, this practical man would expect to find someone who is capable of giving advice in a useful and usable form. Where economic issues in a certain problem are concerned, the economist himself is the appropriate specialist who

should provide the synthesis if he desires that policy should be guided by economic knowledge. But what sort of technique should the applied economist adopt in the way of providing the synthesis? On this interesting issue, Marshall seems to dismiss the contention that sociology might be a complement to economic theory. It does not exist, he maintains, and the only recourse one may have for dealing with social problems as a whole lies in the judgment of common sense. G.S. Shone, on the other hand, seems to hold the view that other social sciences can help the economist by enlarging his knowledge of human institutions and informing his judgment in the same way as direct observations and actual

(1) experience do. J.R. Hicks, however, holds a different view. In one of his works he recognises that the economist, after 'running away' with a problem involving extra-economic elements, always wants to hand the problem in the end to some sociologist or other, if there is a sociologist waiting for him; but very often there is not. (2)

We may agree with Marshall that the economist, who has to insert specific data into his formal theory, may seek them by mere observation and the exercise of common sense. But the economist's reliance on common sense in identifying the specific data, which

(1) G.S. Shone, *Scope and Method of Economics*, *Economic Journal*, September, 1938, p.411.

(2) J.R. Hicks, *The Social Sciences*, London, 1936, p.135.

will constitute the premise of his theory, may sometimes be a source of embarrassment. When dealing with a concrete problem the economist must go beyond pure theory of the hypothetical type "If A, then B", theory which is neither more or less than a tautological exercise in logic. Instead, he must be prepared to say: "Since A, then B. If his studies yield no scientific basis for the verification or confirmation of the premise A, he should confess that he is offering only his personal opinion regarding B, even though the technique of economic analysis has assisted the formulation of his opinion.

Indeed the economist who has to advise on policy, however confident of his common sense and shrewdness of mind and however great his factual knowledge, is still in need of what help he can get in ordering the many factors of which account has to be taken when he deals with a practical problem. The conceptual scheme of economic analysis is believed to be solely an essential guide to solving practical problems, for it does not furnish a body of settled conclusions immediately applicable to policy. The need for a wider theoretical scheme is pretty obvious from the standpoint of the economist who is bound to advise on matters not readily amenable to economic analysis, and on which his opinion is, for the correctness of his judgment, just as crucial as the soundness of his economic theory.

5. THE FORMAL TREATMENT OF THE THEORY OF ECONOMIC DEVELOPMENT.

Attempts have recently been made to avoid the pitfalls arising from reliance on common sense in preference to economic sociology. E.R. Walker, for instance, comes along to suggest a theoretical scheme considerably wider than that of present economic theory; and points out how this new conceptual scheme may be applied to the study of concrete problems.⁽¹⁾ Such a theoretical scheme, he states, can best be described as an extension of economic theory or as a contribution to economic sociology; but what really matters is the question whether it helps to bridge the gap between theory and policy. Broadly, it would offer for consideration two separate but related contributions: (a) a theory to cover certain non-market activities which are vital to economic policy, and which may upset forecasting based on a theory which exclusively covers the market operations; (b) a theory of economic development designed to guide the factual study of changes in such conditions as are given by present day economic theory.

Let us first be clear as to the significance of a formal theory of economic development as such. The prediction of the course of history is not sought by such a theory, for a conceptual scheme is not a body of concrete truth but only a tool for its discovery. Because of the complexity of the real world, we need the assistance of economic theory to elucidate the changes implicit

(1) C.f. E.R. Walker, *From Economic Theory To Policy*.

in given concrete conditions. Obviously the forces making for changes in such concrete conditions are even more complex than those involved in mere adjustments taking place within certain given conditions. Like the pure theory of the market, a pure theory of economic development would consist of a set of assumptions and a logical structure based on them, leading to significant conclusions. The only difference between the two theories, however, lies in the fact that in the theory of the market the assumptions are chosen and the analysis directed in order to yield logical conclusions about market behaviour under given conditions, whereas in a theory of development the assumptions and analysis are intended to yield conclusions as to changes in the conditions themselves which constitute the data of modern economic theory. Of course, a theory of this type would not by itself provide a formal outline of probable future developments; this can only be obtained by the application of the formal theory to the observed conditions. Thus it would serve the same purpose as that of the existing theory in the investigation of a concrete problem; that is, the transition from abstract into realistic economics which will classify the observed facts according to a significant scheme, and reveal what facts must be looked for in a particular instance. But while existing economic theory takes its conditions for granted and can be realistically applied only to predict the future course of events if conditions are assumed to be unalterable,

a theory of economic development takes account of changes in conditions and can be applied to predict how conditions will change in the real world.

The term 'theory of economic development' is thus taken to denote the theoretical study of changes in the data or initial conditions of economic theory. But the same term is sometimes taken to cover the adjustments of the market to changes in the data or conditions of economic theory; hence the distinction between static and dynamic analysis in economic discussions. The theory of economic development, however, may be couched in a comprehensive study, not only of changes in the dependent variables or conclusions which may follow a change in the data, but also of changes in the data of economic theory. In this sense the task of the development theorist is to construct a theory which might help the applied economist to obtain sufficient knowledge of the data, i.e., the exogenous factors or external conditions, of economic theory in order to permit prediction, even though they are subject to change. In other words, the development theorist should seek to endogenise in the theoretical scheme what is conventionally regarded as unexplainable exogenous factors or conditions.

Let us, moreover, be clear as to the possibility of a formal theory of economic development. In this respect, Robbins' position is well known. "It is not possible for us," he says, "to extend our generalisations so as to cover changes of the data. We have seen in what sense it is possible to conceive of economic dynamics -

the analysis of the path through time of a system making adjustments consequential upon the existence of given conditions. Can we not extend our technique so as to be able to predict changes of these given conditions? In short, can we not frame a complete theory of economic development?"⁽¹⁾ Having cast a glance at some of the chief categories of data for economic theory, Robbins came to the conclusion that none of these data is likely to change primarily, or even largely through the processes which contemporary economic theory investigates. "In the last analysis," he maintains, "the study of Economics, while it shows us a region of economic laws, of necessities to which human action is subject, shows us, too, a region in which no such necessities operate. This is not to say that within that region there is no law, no necessity. Into that question we make no enquiry. It is only to say that from its point of view at least there are certain things which must be taken as ultimate data."⁽²⁾

This negative attitude of Robbins, however, should not prevent the development theorist from exploring more deeply the data of economic theory. All it means is that economics assumes certain conditions as being given and just explores their implications and the necessary adjustments of the market to their impact. It does

(1) L. Robbins, *An Essay on the Nature and Significance of Economic Science*, 2nd Edition, London, 1948, p.131.

(2) *Ibid.*, p.135.

(1) F.H. Knight, *Risk, Uncertainty and Profit*, p. 147.

(2) F.H. Knight, *The Ethics of Competition*, p. 174.

not therefore explain those data or induced changes in them. There may be some explanation, but economic science is not in fact seeking to construct a theory covering such explanation, so long as this science studies only the implications of its data. However, there still remains the problem of where explanation of these conditions can be found, if at all.

At this stage, it is necessary to have a clear idea of what are the data, or conditions, of economic theory. Knight provides us with the following list designed to cover the data with respect to which change or the possibility of change should be the subject of theoretical study: the population, numbers and composition; the tastes and dispositions of the people; the amounts and kinds of productive capacities in existence; the distribution of ownership of these productive capacities; geographical distribution of people and things; and finally the state of the arts, i.e., the whole situation as to science, education, technology, social organisation, etc.⁽¹⁾ Once Knight's list of the data or the independent variables in the economic structure is pronounced, the dependent variables may be reduced to the following: the prices of final goods and services, the prices of productive services, the allocation of productive resources among enterprises within each industry, and finally the distribution of final products among the owners of the productive resources.⁽²⁾ These variables

(1) F.H. Knight, *Risk, Uncertainty and Profit*, p. 147.

(2) F.H. Knight, *The Ethics of Competition*, p. 174.

are considered to be the results of the operations of the economic system, and vary according to the concrete content of the data.

However, the distinction between data and conclusions is not so clear as one may think at first sight. The complete separation of conditions from consequences, of data from conclusions, is only possible and conceivable if we merely consider the initial conditions and the final equilibrium position, regardless of what may happen in the intermediate stage between one static equilibrium position and another. But the concrete problems with which the economist concerns himself arise in a community with a past history. The initial conditions, which may lead to equilibrium, always include some factors which are themselves the result of previous economic processes, in addition to factors which are postulated to be exogenous and given. Here we may detect that one channel of economic development is inherent in economic theory itself. It is only in practice that the distinction between the data and conclusions of economic theory appears to be difficult. In theory there should be no difficulty in maintaining this distinction, if we so desire, for all that is required is an appropriate choice of assumptions. The same change may be exogenous to one set of assumptions, but endogenous to another. In practice, however, the difficulties arise from doubts as to which set of assumptions is the more significant for the problem with which the applied economist is concerned.

Methodologically, the treatment of a formal theory of economic

development must essentially begin with a consideration of each of the foregoing categories of data, and the investigation of the extent to which changes in the data appear to be the reflection of some economic processes or of other factors outside the economic system. Whether such a theory has any bearing on the course of economic development in the real world is another problem; this can only be settled by testing the theory against the facts. But since we start with the whole body of economic theory in the background, and then consider the possibility of building a development theory upon the existing body of doctrine, it can be readily seen that, with the appearance of the same quantities as the consequences of one process and the conditions for another, economic development has already crept into economic theory. In a world with a past history, certain prices are the result of preceding given conditions, but meanwhile these very prices constitute the data for subsequent economic processes, i.e., the same dependent variables in the system of to-day become the independent variables in that of to-morrow.

We may recall, in this connection, the well known Marshallian long period analysis in respect of which time is allowed for changes to work themselves out by influencing later short-run adjustments. In fact, Marshallian analysis makes allowance not only for changes in prices, but also for such changes in the state of technology as one consequential on the long-term expansion or contraction of the productive unit.

Again, dynamic analysis in general whether in terms of 'period' analysis represented mathematically by difference equations, or in terms of 'rate of change' analysis represented by differential equations, the adjustment made in one arbitrary chosen period help to determine the conditions to which adjustments are made in the subsequent period. Business cycles are indeed a typical illustration of such a dynamic analysis. The normal type of business cycle theory consists of a series of demonstrations of the manner in which one 'phase' grows out of the preceding one and contains the tendencies which finally brings forth the succeeding one, i.e., the past, the present, and the future are temporally interrelated; the present being produced by the 'pulls' of the past and the 'pushes' of the future. This inter-temporal causal relationship between economic variables whose behaviour over time is neither spontaneous nor instantaneous, whether this relationship is initiated by data changes, or changes in initial conditions, or changes in parameters, is in fact the essence of dynamic analysis in modern economic theory. (1)

Having traced the nature of the data and conclusions of economic theory, it is then worth while to emphasise the need for a formal theory of economic development as defined above. The

(1) C.f. Paul A. Samuelson, 'The Simple Mathematics of Income Determination', in *Income, Employment and Public Policy* (Essays in Honour of Alvin H. Hansen, New York, 1948), pp. 148-9.

economist who advises on practical problems is concerned with the prediction of events. If then he bases his prediction upon the assumption that the data or conditions of economic activity will remain unaltered whilst prices, production and income adjust themselves to the initial conditions, these predictions are likely to be wrong. The conditions themselves are continually changing; partly because some conditions react upon the others directly, as, for instance, the geographical distribution of persons reacts upon their tastes; partly because the best adjustments some people can make to the given conditions is to try to alter them; and partly for no reason at all that is apparent to our limited comprehension of the world about us. The economist is bound to estimate how these conditions are likely to develop in the period under consideration, or to adopt somebody else's estimate; and he must base his analysis of market or extra-market behaviour on the assumption that the data will change according to the estimate.

When past experience includes changes for which no explanation can be offered, the only practical method of predicting future change is pure extrapolation. The chief problem encountered in this method is the determination of the 'true' past trends. Any advance in the technique of observation will improve the chances of accurate extrapolation. Some enterprising economists have contributed to the art of extrapolation; and others may be led, by interest in a concrete problem, to attempt to improve existing methods. There is no reason to consider this work to be outside

the sphere of the economist, any more than the empirical studies which are necessary to verify the assumptions of market theory. But when a group of research workers makes a new speciality of the determination of past trends and the calculation of extrapolated trends, most of us, states Mr. E.R. Walker, will be glad to consult the specialist on all cases where pure, but far from simple, extrapolation is required. Even when science throws some light on the causes of change, it will often be safer to use our scientific knowledge to modify the results of pure extrapolation than to attempt a forecast based entirely on a causal hypothesis. In most economic problems some use of extrapolation is essential, because science can give only an incomplete causal analysis of the changes observed in the past. But reliance on pure extrapolation alone, when our knowledge of the causes of changes suggests that such a procedure would give inaccurate results, is out of the question. The economist concerned with practical affairs must take a lively interest in the extension of knowledge regarding the causes of development; and, in so far as the causes are to be found within the field of economics, it is for economists themselves to discover them. (1)

In this respect, we should refer to Colin Clark's exposition of the purpose of economics, and his contention that "economics in concerning itself only with those things which can be bought and sold for money, remains quite unmoved by the charge that it is

(1) C.f. E.R. Walker, op. cit., p. 191

neglecting the most important aspects of human life. Economics is a wide enough subject already without having to include the whole of philosophy, psychology, sociology and human biology in addition. Let economists get on with their work and let the students of other social sciences get on with theirs."⁽¹⁾

In view of this attitude of Colin Clark, Mr. E.R. Walker seems to provide a convincing answer in the following statement: "The economist has worries enough of his own without extending his investigation into fields already tilled by other sciences. But it is necessary to establish points of liason with these other sciences so that their findings can be utilised in the prediction of economic development. In particular the economist needs to know whether other sciences have determined unambiguously the past trend of the conditions of economic activity and whether they have discovered the causes of changes in these conditions. If other scientists, working in the fields to which these questions are appropriate, tend, under the pressure of other interests, to neglect or postpone the investigations which might provide answers for the economist, he must take the initiative himself and press for the recognition of his problems by other sciences."⁽²⁾

This discussion may thus point the way to a field for research rather than providing at once the additional knowledge which is suggested as necessary for realistic economics. But it must be

(1) Colin Clark, *The Conditions of Economic Progress*, First Edition, London, 1940, p.1.

(2) E.R. Walker, *op. cit.*, p. 192.

pointed out that, beyond a certain point, the cultivation of this field, in only general terms, will yield decreasing returns. Just as the conditions of economic activity vary from place to place and from time to time, so also the rate and direction of change, and even its causes, will vary. This is the reason why it is so difficult to make any attempt to predict "economic evolution" for the world as a whole. But the economist is more likely to be asked for advice on limited, local problems, and he can therefore manage to go on with his minor field of research. And, even though the backwardness of some sciences may leave considerable gaps in any attempt to present a synthetic estimate of future changes in the data of a particular economic problem, it is suggested that the capacity to make the most of available facts in such estimates should form part of the equipment of the economist. This capacity is more likely to be developed by the systematic exploration of the problems of economic development and by the cultivation of the necessary contacts with other sciences than by concentrating on the study of equilibrium theory and trusting to common sense for the rest. Moreover, it is necessary to pose the general problem involved in the prediction of economic development, in order to stimulate the analysis of those economic processes which are partly responsible for the data changes. This is the specific contribution which the economist might be expected to make to the theory of economic development, as distinct from the synthetic contributions of various other sciences.

If this is the specific contribution of the economist to the theory of economic development, he should make his knowledge of the economic causes of data changes as full as possible. The results of pure extrapolation into past trends have to be corrected in the light of scientific knowledge of the causal hypotheses of change. This would lead him into the exploitation of those existing economic theories which throw light on development, as well as to the construction of new ones to fill the gaps in his analytical technique. Does this mean, it might be asked, that we should add to economic science a special department, like the production, exchange and distribution of earlier economists, and the statics and dynamics of the most modern? Professor Roll has indeed devoted a whole part in a textbook for the discussions of "Problems of Change". About the causes of data changes, he holds that modern economics can say little. It may be possible to enunciate general laws of change, but it is beyond the competence of the economist of to-day to do so; the knowledge of the historian, sociologist and philosopher is required as well. However, he admits that the economist can make some contribution towards answering enquiries into the causes of change, for some of the causes lie within the economic system. But there are other causes to be taken into account as well. ⁽¹⁾

It might seem preferable, therefore, to place the problem of economic development, in terms of economic causes of data changes,

(1) E. Roll, *Elements of Economic Theory*, London, 1937, p. 205.

among the central problems of economic theory, on an equal footing with the adjustment of the market to given data. Then the two types of analysis can be elaborated in close relation to each other; and in many of the theories of which the establishment of equilibrium at present appears to be the climax, the analysis can be pushed on into the realm of data changes.

It then follows that a formal theory of economic development, in its narrower sense as defined above, has, as its goal, the discovery of those economic processes which contribute to the production of data changes. In its broader sense, and in a more comprehensive and systematic form, the theory should tackle the following questions in respect of each of the data of economic theory: (1) the nature and form of the data, (2) the dynamical development of the data over time, and investigation of the economic causes of changes in these data, if any; (3) the investigation of the market or extra-market adjustments necessary for the "absorption" of the data changes into the economic system; (4) prediction of the future development of the data, to be based on extrapolation corrected by the establishment of scientific causal hypotheses, if any; (5) control by public policy of the development of the data in question by influencing the course of their future development, with the aid of knowledge about the data changes.

Once a theoretical construction, whether in its narrower or wider sense, of the development of data has been incorporated into

the body of economic theory, we are no more tied to the orthodox methodology and the narrow boundaries of the economic science, which have long been set by the orthodox school, and which would lead us nowhere in terms of realistic economics. Assumptions of this school have fundamentally been that of "statically" given resources and given conditions. But we live in a dynamic world, in a world in which data or conditions of economic theory as well as resources as part of the data vary as between different places and different periods of time.

6. THE 'NEW' TREATMENT OF THE THEORY OF ECONOMIC DEVELOPMENT.

Data changes, however, may be for better or for worse, depending upon whether changes as such would produce an increase or a decrease in real national income and wealth. In other words, our primary concern is not so much to build up a formal construction of a theory of development for its own sake, as to sort out those constellations of data changes which, at certain stages of the development of a certain society, would bring forth economic progress and material welfare for the society as a whole, and those constellations of data changes which, at other stages of development would result in economic stagnation or decline, when the economic system is bound to adapt itself to such data changes by market or extra-market operations.

This new treatment of the theory may look different from the formal treatment as defined above, at least in form if not in essence; but it may contribute more, and in a realistic sense, to the understanding of the causes of economic progress and stagnation. In solving a minor practical problem, the 'formal' treatment may be useful to the applied economist who is equipped with better tools of economic theory in which data changes are to be taken into account. The 'new' treatment, however, has a much wider scope, and a greater and much more important object. Its scope is the whole world, for it deals with a major economic problem which is common to every country. Its object is the study of the problem of how to increase material wealth and maximise economic welfare in a dynamic economy, with resources and conditions changing over time. Whereas the 'formal' treatment seeks to deal with each and every datum and its dynamic development separately, the 'new' treatment seeks to study a hypothetical society which presumably passes through successive stages of development, and in each stage the relevant data, their development and their effects on the level of economic activity are collectively tackled and analysed. This does not mean that reference has to be made to any particular society or any particular historical period. It is a mere hypothesis in relation to which four sets of questions may be posed.

The first question deals with the circumstances under which economic progress obtains. Historically, many societies stagnate for some time and then suddenly become prosperous. It is then most

interesting to investigate the pre-conditions necessary for the achievement of such economic prosperity. The second question deals with the policies which promote progress. For once economic progress emerges, it is equally interesting to investigate the mechanism whereby this incipient progress can be assisted to develop and perpetuate itself. After a rapid economic progress has been achieved, it is then desired to know whether the economic system has a momentum of its own, a cumulative pressure moving the economy upwards. But once it is assumed that there exists a cumulative pressure upwards, by implication there should also exist a cumulative pressure downwards. Is decay Inevitable? This is the last set of questions which evidently stems from the preceding one.

But why should there be any attempt to study a theory of economic development in this sense? In answering this question, it is well to bear in mind the records of history. All down the sixteenth, seventeenth and eighteenth centuries, there was a certain intellectual atmosphere. Nation states were born, and kings were anxious to make their nations strong and powerful. This was the Mercantilist Age. From about 1500 right up to Smith's day, there had always been the question "What are the causes of economic progress?" Yet Adam Smith assumed a negative attitude in 'Wealth of Nations' by laying great emphasis on the concept of economic freedom. The invisible hand would work the miracle and the economic system would look after itself. No state interference

was needed to stimulate economic prosperity. State interference was in fact not only deemed unnecessary but even harmful to the progress of the economy. Even if this was not intended by Smith to be the answer, it was thought to be so. Once it was accepted, the interest in the fundamental question faded away. Since then, almost no economist has seriously endeavoured to answer it. Generations of students have been trained in the field of economic science with its narrow and traditional scope for the last hundred years or so, without their attention being drawn to the investigation of the question that was seemingly overshadowed by Smith's writings.

But the year 1929 saw the precipitation of a sharp slump and a prolonged period of stagnation accompanied by immensely large figures of unemployment of a permanent nature. People then began to enquire what was wrong with the capitalist system, what were the causes of secular stagnation. Besides, Indians, Chinese, Egyptians and other peoples in the so called under-developed areas began to enquire why their agrarian economies have permanently been under-developed, why stagnation has been the normal state.

The economist is bound to answer these most interesting questions. Once they have been satisfactorily answered, it must be admitted that there can in fact be a theory of economic development to be based on history, sociology and abstraction in the realistic sense, i.e., of changing, and not given, conditions. It must be admitted that there is a problem and it has to be solved;

and the method of approach is analytical, historical and dynamical. It is analytical because we seek to discover the economic causes of changes in conditions and the market and extra-market adjustments necessary for the 'absorption' of the data changes. It is dynamical because the changes in the data cannot be conceived of as instantaneous in a 'static' sense and a period analysis should be involved here. It is historical, not because it refers specifically to a certain historical period or periods, but because historical facts and observations are invoked, now and again, to validate the analytical aspect of this approach. "To understand the world in which we live," says J.E. Rees, "it is necessary to have some idea of how human society came to be what we now find it. Without this knowledge we cannot attach any meaning to such things as the present distribution of population, the economic activities of different countries, and the institutions which bind communities together, for all these are the results of the interplay of forces over long periods of time. Whether we approve of existing conditions, or whether we find them intolerable, we shall achieve little by way of defence or attack unless we know something of history."⁽¹⁾

But what of history? Rees again provides the answer. "It is sometimes taken to mean what has happened in the past in so far as it is known, for only a fraction of what has happened can be discovered, because records are lacking, or are imperfect, or are

(1) J.E. Rees: 'A Survey of Economic Development,' The Approach to History, p.1.

difficult to interpret. History, however, is not merely a collection of details; it is also the arrangement of the facts in order to offer some kind of explanation of their meaning. Possibly we shall be able to establish some general principles which help us to understand the present; but such principles will always be subject to modification with fuller knowledge."⁽¹⁾ But Rees advances not only the qualification that our knowledge of history is imperfect, but the further qualification that history cannot be explained objectively. There is no knowable force, divine, cosmic, or physical, he states, which can be proved to be the prime cause of what we call history. With our imperfect knowledge we can only offer subjective explanations, and these have no final authority. The historian can exert himself to discover as precisely as possible what actually happened in the past, and he can attempt so to relate facts that they give a satisfactory clue to the sequence of cause and effect. But the explanation he offers is merely his opinion, based on an examination of evidence and always relative to his right to have an opinion at all.

Imperfect knowledge of facts and the subjectivism involved in their interpretation are therefore two serious qualifications which should make us very chary in our approach to history as a means of verifying causal hypotheses based on abstract reasoning.

So much for the method of the new treatment of the theory of economic development. It is well in order to turn to the scope

(1) Ibid.,

of the theory and try to answer the aforementioned questions in a summary form. In the writings of economists, there is to be found no answer to the first set of questions, i.e., the circumstances under which economic progress obtains. Old economists were living in an era in which the economic system was operating progressively; it is no wonder therefore that they were by no means interested in a question of such a kind. It is the historian who has shown a tendency toward the investigation of the factors underlying the phenomenon of stagnation. Some historians, for instance, believe that progress essentially depends upon the existence of a creative minority in the human society. By tradition, most human societies are conservative and hostile to the innovating spirit. It is only when pioneers with power, initiative and integrity overcome the society's natural and innate opposition to the new ways of doing things, that economic progress is likely to emerge. But there must be a particular social pattern in which pioneers meet with the least resistance from the conservative elements in the society. Some particular social shocks can be envisaged as factors which aid the new in destroying the old, e.g., wars, plagues, and foreign trade. These factors tend to loosen the fetters of the society and weaken its resistance to changes which can only be initiated by the creative minority. Some historians, however, are inclined to attribute the phenomenon of stagnation to the existence of such social institutions as the class structure, slavery, caste, religion,

family and the theory that each new technology needs a new social pattern. Needless to say all these institutions have direct bearing on economic progress. Other historians, however, attach importance to geographical situation. They hold that man is the creature of his environment, necessarily obeying the laws which are inherent in material things. He has the illusion of free will; but as a matter of fact he is purely an organism operated upon by outside forces. There is no more purpose in the life of mankind than in that of the animal creation or the physical universe - all obey laws because it is inconceivable that they should do otherwise. What are these material forces? They are sometimes comprehended in the terms "nature" or "climate". All human life, indeed, is conditioned by its environment, but it also reacts on its environment; in some cases the reaction is slight but in others it is considerable. It is easy to trace the control exercised by environment in primitive societies. Other historians even say that such waterways as rivers, lakes and seas are essential to mobility and trade in the same way as the inland means of transport are. Where there exist such waterways or other means of transport in a geographical situation, there will also be a case of economic development. Some historians even go so far as to say that a favourable situation means greater activity in foreign trade and easy access to the foreigners, whose role is no less significant in the achievement of any degree of economic progress. To study the first question therefore is to study history, geography and sociology.

The second question deals with the ways or the policies by which economic progress is promoted and speeded up. On this issue economics has an important part to play. As has been pointed out, the question disappeared in the economic literature after Adam Smith, perhaps with the exception of J.S. Mill who considered it briefly in his 'Principles'. List then came along to scorn the writings of Smith in an attempt to substitute state interference for laissez-faire in the running of a capitalist system. Marx, however, was not interested in the capitalist system, but only preached for its overthrow, and thus the Marxians were not concerned with economic progress to be achieved in a capitalist society but with the uprooting of capitalism itself. Then came the "marginal" revolution in economic theory, which carried with it the firm belief that since a capitalist system, with perfect competition, private enterprise and a pricing mechanism is assumed, by marginal analysis, to effect the best allocation of the community's resources, the community would certainly stand to lose if any interference with the invisible autonomous mechanism were contemplated. Jevons, as one of the leaders of this school, even denied that the question seemed to be relevant or important. Thus although a tremendous amount of writings on this particular question can be traced during the period 1500-1776, nothing in fact was written since then.

No one, before Malthus, answered the third question whether the economic system generates a momentum of its own. The essence

of his population theory is that, if population went unchecked, it would multiply by leaps and bounds. But there in fact exist three checks: misery, vice and moral restraint. Land being given as a fixed factor, people will continue to live at the subsistence level. If their wages rise above that level, they reproduce themselves in such a way that a greater number of people will co-operate with the fixed factor, land, in producing the national product. It is thus that the wage-level is bound to fall off again to the subsistence level. This misery and lowering of the living standard will check the growth of the population and help keep it in line with other available fixed resources. The theory is therefore based on two principles: diminishing marginal returns, and the close relationship between the wage-level and the size of population. On the assumption that land is a fixed factor, the living standard of the masses will never improve, for it will always be pegged at the subsistence level according to the foregoing relationship. In other words, the Malthusian scheme implies no possibility of economic progress so long as the system generates a momentum which tends always to push it downwards. This gloomy picture affected Ricardo who indeed elaborated on it to a great extent. J.S. Mill, in his turn, accepted the answer to the third question as given by Malthus and elaborated by Ricardo. Marx did not accept the Ricardian doctrine but he did make use of his method in propounding the concept of the falling rate of profit. Thus Malthus, Ricardo, Mill and Marx, all professed stagnation and

implicitly established that the economic system creates within itself a cumulative force, which is constantly pulling it downwards and hence inevitably putting an end to progress. This orthodox gloomy view dominated the minds of the students of economics right up to the turn of the century, when the marginal theory dropped this view. Afterwards came Marshall to disbelieve the possibility of stagnation. Keynes then came to build up a theory of chronic unemployment based on his idea of oversaving in a developed economy, coupled with a secular fall in investment prospects resulting from a continued fall in the marginal efficiency of capital. Hansen took the idea of oversaving from Keynes and elaborated on it with reference to the American economy, and in so doing, was led to propound his four well-known pillars of secular stagnation in a "mature" economy. Schumpeter, however, denied this idea of secular stagnation; but he also believed that capitalism as a system was bound to come to an end because it would bring about its own destruction as a result of the new social institutions and ideas which had been alien to the system in the past. Nevertheless, any other system, in his opinion, would be worse. Finally Colin Clark came along to investigate the way in which man-power is distributed among primary, secondary and tertiary industries. He also collected statistical data related to the rate of saving a community tends to undertake, investment outlets and the multiplier effects upon the trend of the national income in the long-run. In this way he seemed to throw some light upon the

question. Since then no writings have been made on the subject. Broadly, the third question explores the following topics: the impact of progress on institutions and ideas, the laws of capital accumulation, the laws of population growth and its effects, the inevitable concentration of property, the inevitable urge to war and imperialism and the pattern of progress.

Finally, the fourth question deals with the possibility of economic decay. Does the society produce conditions that arrest itself? The answer may be that the capitalist system has created trade unions which are likely to be opposed to new ideas and new productive techniques. This reactionary attitude, on the part of some trade unions, may sometimes be inimical to progress. Moreover, ideas of democracy and equality have permeated capitalist societies, and the proletariat make use of these ideas to demand economic equality. This has resulted in the tendency towards more and more progressive taxation designed to diminish inequalities of income and wealth. But a tax system of such a kind may well eat into savings which would otherwise be absorbed into investment outlets. Hence there might be a short supply of capital in the market and an ultimate diminution of the level of investment as a result of a highly progressive fiscal policy. Again, a full employment policy, if maintained, might involve a lack in the spirit of discipline among workers, with lower productivity and wastage of resources as a result. Indeed the fourth question may

include such topics as population theories of secular stagnation; the exhaustion of the creative spirit; the creation of checks to progress, e.g., trade unions, monopolies, barriers to migration, tariffs; loss of flexibility; secular stagnation through falling propensity to consume; exhaustion by empires and wars; exhaustion by growing taxation and national debt; exhaustion by the class struggle; and exhaustion of soil and natural resources. The fullest elaboration on economic decay is found in Toynbee's 'History of Civilisation'. In this work, he comes to the conclusion that all systems in Western Europe follow the same inevitable pattern of stagnation; but as a Christian he leaves a way of escape for his fellowmen that they should not lose hope and faith in a decent worthy life.

In this sense, a hypothetical society as defined above seems as if it were bound to revolve in a vicious circle, starting with stagnation and ending with the same point from which it has started.

7. SUBJECT AND PLAN OF THE WORK.

Now that the broad outlines of the method and scope of the new treatment of the theory of economic development have been defined, it is proposed to delimit the subject of this work. Its chief aim is to pursue a detailed and comprehensive study of the first two topics covered by the theory, viz: the circumstances under which economic progress obtains, and the policies which

promote progress. The main reason for this partial study of the theory is the great interest that has recently been shown by national and international agencies in the economic development of the so-called backward areas of the world which make up two-thirds of the human race.

But it is perhaps much more instructive to begin with a very brief historical survey of such fragments of the theory of economic development as can be found in the writings of some of the old and modern economists. Apart from its academic interest, this historical study of the trend of economic thought, in so far as the development theory is concerned, may be useful in throwing light on the later discussions of the problems involved in the two topics with which this work is primarily concerned. Besides, this study in itself may prove that the treatment of the theory of economic development can then be seen not only as a reaction against the modern trends which make economic theory less realistic, but also as the continuation of a point of view which has always been present in economic thought.

CHAPTER 1.

THE THEORY OF ECONOMIC POLICY IN PRE-CLASSICAL THOUGHT.

1. THE MERCANTILISTS.

The general statement that economic thought tends to reflect the economic and social conditions of its time applies equally to modern economics and to the economic doctrines of the pre-capitalist society of the Middle Ages. Just as modern economic doctrines deal with the PART I of the market economy, so are the economic doctrines of the Middle Ages related to the economic problems of the feudal society. Unlike capitalism, the feudal society was fundamentally a "planned economy". Production, distribution and prices were determined not by the interplay of supply and demand but by authoritative control in accordance with generally accepted rules and customs. Whereas modern economics searches for causal relationships, the medieval thinker was preoccupied with the fairness and justice of a particular price. In other words, economic issues were viewed from the viewpoint of the medieval

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time. In fact economic thought was part of a system of applied ethics. In the pre-capitalist society of the Middle Ages therefore people were not interested in economic development in itself, but only whether the new development was sinful or, more precisely, compatible with Christian tradition. Ethics and Economics were indeed merged into one whole.

But whereas the economic theories of the Middle Ages had their common roots in Christianity, in Christian ethics and in the doctrines of just price, the theories of state economy characteristic of the sixteenth, seventeenth and eighteenth centuries, which are usually referred to as mercantilism, reflected the then prevailing conceptions of the absolute state. Just as the political units, e.g., manors, cities, counties, and regions had to be centralised under one administration, so regional economics had to be integrated into one unified market system interconnected by trade, division of labour and a uniform medium of exchange.

Mercantilist statesmen and businessmen such as Jean Bodin (1530-1596) and Thomas Mun (1571-1641) were indeed the first writers who thought of economics in terms of political economy rather than a part of applied ethics and theology. For the first time in the history of economic thought, economic problems were seen from the point of view of a unit larger than that of the local and self-sufficient manor, the guild, or the city. In fact mercantilist writers were the first to realise that political

economy had to concern itself with the nature and causes of the wealth of nations, to look upon the national state and governments as the agents whose main task was to foster national production by internal improvements, by the promotion of national industries and by the removal of all local barriers.

But what, in the eyes of the mercantilists, made for a nation's wealth and power? During the mercantilist age, the king assumed the duty of the defence of the country and the promotion of its welfare. Thus the new age of standing armies required permanent and regular money resources. Again, new discoveries of silver, the influx of which into Europe rapidly revolutionised its commerce and finance, constituted one of the finest examples of the quantity theory of money in practice. Moreover, this very influx of silver over the fields of trade resulted in the transition from a natural to a money economy. No wonder, therefore, that wealth as the source of a nation's power and strength took the form of money or, more precisely, such precious stones as gold and silver and which was therefore worthy of all respect, both by the state and by the individual. In the pursuit of sources of wealth, the state was directed to colonial acquisition, rivalries and even open hostilities. The individual, in a similar way, was in pursuit of wealth. In a 'natural' economy, it had been sinful to accumulate wealth; but in a money economy, accumulation of wealth was looked upon with favour. It is, however, the conditions of the time that attached new importance to wealth. Centralised states were living

in unending rivalries; each was struggling to be strong against possible competition; and each was striving to have its rightful place under the sun. And, as the individual could then pursue wealth shamelessly, so also the state saw in wealth the source of strength. This is indeed the kernel of mercantilism.

When the mercantilists came to look for a test of the strength of a country, they found it in its wealth; and above all in that portion of wealth which consisted of the precious stones. The mercantilists regarded wealth as a stock of something. We now regard it as a flow of production, but this is only a recent view. The stock of wealth in that age was in the form of gold the preoccupation with which was manifest in mercantilist policy. In the absence of mines of gold and silver, it was the prime policy of the mercantilists to bring about a permanent favourable balance of trade, with a view to increasing the supply of gold and silver in the country. It was the implication of this policy that the country should be industrially developed and that there had to be an hierarchy of occupations. Although agriculture could feed the population and its expansion by intensive and extensive methods and might render certain imports unnecessary, it was thought to be the least important of economic activities. Like all other domestic trade and industry, agriculture brought no money into the country, and thus on the cruder mercantilist theories it did not increase the country's wealth. Manufacturing industry and foreign trade were the most important of economic activities.

During the reign of Edward III, foreign craftsmen were encouraged to enter the country in order to promote its industrialisation. The clothing trade, for instance, was based on the Flemish weavers. Again, under Queen Elizabeth I, foreign craftsmen were induced to settle down in the country and set up new industries. Foreigners came under a contract whereby a monopoly was granted to them for a period of 25 years after which time Englishmen would have been taught the technical processes. Patent rights were also granted to foreign inventors for the sake of encouraging inventing ability, and these rights were later extended to Englishmen as well. Acts of Parliament made it quite clear that patents could only be granted in respect of new inventions and new industries.

Moreover, whereas medieval policy was aiming at the restriction of exports, the mercantilist point of view was diametrically opposite. It was the removal of all restrictions on exports of home manufactures that constituted the crux of mercantilist policy. Foreign trade was indeed the main object of economic policy during the mercantile age, a policy which was directed to bring about a permanent favourable balance of trade by way of minimising imports and maximising exports. Import restrictions could be put into effect by laying down laws against luxuries. In this respect, Mun expressed the view that imports of wares to be consumed solely by the wealthy class contributed nothing to the real welfare of the country. The reduction in

imports could be made possible by rendering some of the imported goods unnecessary for home consumption; this could be achieved by protecting native 'infant' industries, and also by bringing in foreign craftsmen who would play an important part in the promotion of such industries, or the establishment of new ones in competition with, and as substitutes to, imported manufactures.

The export drive, on the other hand, could only take effect by removing all restrictions on exports except for raw materials. If the nation took legal steps to ban exports of raw materials, the result would be to preserve the essential materials for home industry. A striking illustration in England was the establishment of wool manufacture, which was primarily aided by the device of putting an embargo on exports of raw wool abroad. It is interesting to note that such a mercantile policy is still pursued nowadays in many countries whenever raw wool is in short supply. The export drive could also be assisted by encouraging inventive ability through the establishment of legal rights of patents and statutes of monopolies. It was a commonplace at the time that technological advancement to be brought about by the encouragement of inventive ability would put the country concerned technically far ahead of other countries in manufacturing business, and thereby in a very favourable position in world markets. It is interesting, too, to note that, in the Great Britain of to-day, the same argument is being put forward as more and more of the economically backward countries are being industrialised. The encouragement of large

population was also thought at the time to be one of the driving forces towards the increase in exports, for it was held that the larger the population, the greater the supply of labour; and hence under competitive conditions of the market the lower the wage level. And, since wages constitute a large part of the production costs, especially in those days when mechanisation and industrial revolution were still far away in the future, this meant that the costs of production of exports would be reduced all round; and presumably along with a fairly high elasticity of world demand for such manufactures, this would give rise to a big increase in the quantum and value of exports which is a fundamental object of mercantilism.

The mercantile age was thus marked by considerable regulations and statutes; and mercantilism was a continual state activity in the economic field. There was nothing the state might not do and nothing it ought not to do, if its activities were designed to promote the general well-being. With respect to import restrictions and the encouragement of exports, the mechanism was in the form of import tariffs so as to keep out foreign goods, and in the form of export subsidies so as to promote the sale of domestic goods in world markets. The issue of patents and legal monopolies was intended to encourage inventive ability and promote the introduction of new processes. The purpose of importing foreign skilled labour was evidently to establish new industries. Prices and wages were fixed by the state as a part of public policy in the interests of

production. A whole series of devices were made in order to encourage shipping and the Navy, of which the Navigation Acts were the most familiar and the prescription of fish days the most curious. Besides, many privileged trading companies were created to promote commerce. Plantations were founded overseas in order to secure supplies of primary products as well as markets for home manufactures. Some regulations, furthermore, laid down specifications of cloth and other finished products.

Initially the aim of state interference into the economic life of the country was to promote industry and maintain a high standard of workmanship, but in some ways this government action proved to be a hindrance to industrial development. In France, for instance, it caused considerable discontent. In England, on the other hand, the system of apprenticeship was a salient feature of state interference in industry, and the regulations thereof were originally laid down for the good purpose of increasing the supply of labour in certain crafts in order to develop industry. But eventually the Statute of Apprenticeship was so abused as to constitute a deterrent to new entrants to the crafts, and hence create an artificial scarcity of the supply of certain types of labour.

Mercantilist writers hardly attempted to answer the question why such an importance as they expressed in their writings was attached to stock. They simply took it for granted that an increased quantity of money gold tended to inflate prices; but they

attempted to explain that increased prices were indeed one way of improving the terms of trade. When home prices were pushed up, this implied the prospects of selling dearly and buying cheaply; otherwise the terms of trade would turn against the home country. This view has seemed to be absurd. England would only be richer if the terms of trade were moved against her; and even to-day some writers express the view that Britain would have been less severely hit by the slump of the 1930's had the terms of trade been moved against her. (1) Petty recognised that when inventions improved the productive efficiency of the country, and thereby production costs were lowered, this fact would enable England to undersell other countries; but still the terms of trade would have been against her. The mercantilists countenanced this view when they maintained that, in the interests of the export trade, wages of labour had to be lowered. This line of argument is obviously contradictory to the other argument in favour of improving the terms of trade. However, mercantilist view as regards gold movements was that when gold entered the country through a favourable balance of trade, this meant a greater supply of money which would in turn bring about a reduction in the interest rate. Such a result would stimulate production by some mechanism which we call to-day the multiplier effect. This analysis is purely Keynesian in essence, or more correctly the Keynesian analysis is Mercantilist.

(1) W.A. Lewis, *Economic Survey, 1919-1939*, pp.192-8.

By the end of the seventeenth century, however, Mercantilism as a body of doctrines and practices began to fade away and give way to others. Gold was losing its importance as a result of the recognition of the quantity theory of money. Gold, even though it was of higher value relative to other commodities because it was scarcer, was no more important for the society than any other commodity. In this matter, Petty expressed the view that England should actually have just the reasonable amount of money; for if she had more than that amount and the extra supply of money was put into circulation, prices would be inevitably inflated, whereas if she had less than that amount prices would be deflated; neither courses were advisable.

Another reason for the breakdown of Mercantilism was the fact that some economists, by the end of the seventeenth century, began to distinguish between gold and money, and came to realise that they were not the same thing. There emerged a school of such writers as John Locke, which maintained that once paper credit could do the work of gold, gold would cease to have a prime importance as a standard of value and medium of exchange.

Moreover, the emphasis began to shift from foreign trade to the establishment and development of industries for home consumption. Writers began to think of value as the product of labour; manufacturing industry was important simply because in its output were embodied both the product of labour and the value of the product. Foreign trade, in other words, was out of the picture.



Finally, the development of political philosophy, i.e., the natural law and the natural order of the society, had its influence on economic thought. When the concept of the 'natural order' was to be applied to the economic aspect of human activity, this application was equally to result in the parallel concept of 'laissez-faire' in Economics. Evidently this concept runs counter to the mercantilist doctrine of state interference. and agriculture is itself the sole source of wealth and the only productive industry.

2. THE PHYSIOCRATS.

Full reaction to the mercantilist doctrines was taking concrete shape by the middle of the eighteenth century on the part of the physiocrats. Francois Quesnay was the most notable writer of this school of thought; he is rightfully regarded by economic historians as the true representative of the whole body of physiocratic theory. In his writings there can be distinguished three points of a general character. First, economic doctrine, in his view, is really only a corollary to something much larger which is perhaps the foundation of the whole structure of society. This is to be found in his conception of, and distinction between, the natural and positive laws. Secondly, the real foundation of the science of Political Economy, in the modern sense of the word, can be said to be laid by Quesnay, with whom indeed the empirical element disappeared. He observes shrewdly that the problem of wealth, the conditions of its production and the laws of its distribution are

matters to which there can be applied precise scientific reasoning for purposes of arriving at generalised truths about economic life. Finally, in the eyes of economic historians, Quesnay is regarded as the very economist who truly anticipates Adam Smith.

The search for the natural order leads, on the economic side, to the adoration of agriculture by the Physiocrats, in whose eyes agricultural countries alone can establish empires, and agriculture is itself the sole source of wealth and the only productive industry. The physiocratic emphasis on the importance of agriculture as such was no doubt the reflection of the needs of France at the time as well as a reaction against a phase of Colbertism, the French synonym for Mercantilism, which stressed the importance of manufacturing industry.

The physiocratic school of thought seeks to prove that agriculture alone produces the wealth of the country, and unlike this activity productive of wealth, all other activities are 'sterile' in the sense that in the former there is a 'surplus' whereas the latter, e.g., manufacturing industry and commerce, just pay their way. More precisely, agriculture is the only industry that not only provides for wages and profits accruing to the owners of the productive services engaged on the land, but when all expenses have been met there still remains something over, a residual income, a rent payable to the proprietor. This is, in the eyes of the Physiocrats, the real revenue of the nation supporting commercial and manufacturing classes.

In so far as commerce is concerned, the physiocratic view corresponds to what is an instinctive reaction of the unsophisticated mind that mere exchange is in no way an act of production. With respect to industry, the physiocratic argument is based on the fact that the common value of any commodity is merely the value of the original material and the cost of the subsistence of the artisan during the production period. The product of the artisan is therefore just worth the productive costs involved in the process of manufacture, and the artisan merely acquires the right to share in the consumption of the wealth produced by the cultivator. In this sense, unlike agriculture, there is no 'surplus' in industry.

A corollary of the physiocratic conception of wealth was that something should be done to stimulate and develop agriculture at the expense of other economic activities. On this general view of relation between different classes of society, encouragement of agriculture became the chief aim of physiocratic economic policy. In Quesnay's view, agriculture should be conducted on a large scale, and capital should be invested on the land in order to make this line of economic activity all the more profitable an employment. So, negatively, manufacturing industry was not to be promoted at the expense of agriculture; but this did not necessarily mean that the former was considered to be almost superfluous and in no way useful from the national point of view. All that Quesnay's writings really implied was only to lay much more emphasis on agriculture than on other occupations from the point of view of the generation

of wealth. But Quesnay's contribution did not stop at that. He proceeded to advance an analysis of the circular flow of goods and money, and the functioning of the economic system as a whole. His *Tableau Economique* was an absolutely new approach to economic science at the time. This new approach was not only an analysis of the circular flow of goods, but was something approaching the breakdown of the older conception of wealth. Quesnay spoke of wealth as a 'flow' concept rather than as a 'stock' concept, so to speak; in other words in terms of national income rather than national capital.

Quesnay's definition of wealth, as consisting of the sum total of things necessary for life and in the annual reproduction of such things, has led him to the logical conclusion that the quantity of money in circulation may decrease or increase without any corresponding decrease or increase in the things necessary for life. In his view, the wealth of a country should not be judged by a greater or lesser supply of money that it possesses. Money is neither more nor less than sterile riches. Its chief utility consists in facilitating exchange and effecting purchases and sales in the market. It is merely a standard of value, to which prices of all other commodities are related, as well as a medium of exchange for these commodities. Furthermore, buying and selling are but two aspects of one and the same transaction. It then follows that the central idea of Mercantilism - that of a nation selling more than it purchases - is not only mistaken but also

ridiculous. It can mean nothing but preaching for the impoverishment of the country by losing wealth, when it sells more than it buys. The excess of sales over purchases is in no way compensated for by the accumulation of money gold, for gold is not wealth in itself; it is but a sterile commodity giving a conventional command over wealth. Great Scottish Philosopher, shared

Another characteristic of Quesnay's writings is his advocacy of free trade. Commerce, he states, must not be considered as an undeclared state of war as between different nations in the sphere of business relations. On the contrary, it is only in the interest of a nation to leave trade entirely freed from any restrictions or control by the state in such a way that the forces of competition in the foreign market may secure for the nation the highest possible price for its exports and the lowest possible price for its imports. However, it would be a gross error if this were taken to mean that the physiocrats' advocacy of free trade attached particular importance to foreign trade. On the contrary, foreign trade, like domestic trade, was for the physiocrats essentially an 'unproductive' occupation; and this ran counter to mercantilist doctrine. But when Quesnay was preaching for a free trade policy he was evidently speaking with the voice of Adam Smith.

value, the real revenue of the land, the only source of wealth, and by implication that the state should not interfere with it in this sense. Smith refused to see the distinction between the annual labour of every nation was the source of the

CHAPTER 2.

THE THEORY OF ECONOMIC POLICY
IN CLASSICAL POLITICAL ECONOMY

1. ADAM SMITH.

Adam Smith (1723-1790), the Great Scotch Philosopher, shared with the Physiocrats and with other representatives of eighteenth century thought the belief in a natural order. This belief was founded on ideas which were partly moral and religious and partly philosophical. This attitude of Smith has led him to such an optimistic view of a world as would imply an invisible hand, whose secret intervention in the social activity of man in his pursuit of gain, would miraculously harmonise self-interest with public interest.

Smith's conception of wealth was entirely different from both the Mercantilists and the Physiocrats. Broadly, the Mercantilists had attributed the increase of the wealth of nations to a favourable balance of trade bringing forth an accumulation of money gold and silver, the sole source of wealth and of power in their opinion. The Physiocrats, for their part, had contended that wealth sprang solely from the pursuit of agricultural industry, whose surplus value, the real revenue to the nation, was indeed its real wealth; and by implication that all other occupations were 'unproductive' in this sense. Smith refuted these fallacies and emphasised that the annual labour of every nation was the fund which originally

supplied it with all the necessities and conveniences of life which it consumed. The source of all wealth, in his view, was thus to be found in labour; and an increase of wealth was to depend on the skill, dexterity and judgment with which labour was supplied, i.e., on the productivity of labour in modern terminology.

Taking this view as a starting-point in his analysis, Smith places the principle of the division of labour in the forefront as the cardinal fact of economic life. In his exposition of this principle, he points out that wealth depends on the productivity of labour. Division of labour increases this productivity, permits specialisation in the process of production, and through it the use and development of elaborate machinery. But he proceeds to emphasise that division of labour is limited by the extent of the market; and, as a corollary, all barriers to trade must be broken down. He advocates colonisation and regards colonies as a source of the supply of necessary raw materials as well as an extension of the home market.

Moreover, Smith follows in the steps of the physiocrats and brings in his writings the evil legacy of the distinction between 'productive' and 'unproductive' labour. But with Smith the two words have then definite meanings. Productive labour, according to Smith, is that which adds value to the raw materials to be worked upon; whereas unproductive labour is that type of labour which, however useful it may be, ends in no increase in value. In his language, the labour of the manufacturer fixes and realises

itself in some particular object or vendible commodity which lasts for some time at least after the labour is past; therefore such labour has been productive. On the other hand, the services of a menial servant generally perish in the very instant of their performance. Thus the Smithian test of productive labour is that labour should realise itself in a vendible commodity or result in a higher vendibility. On this view of productivity of labour is based the charge of materialism which the German idealist school puts forward against Smith. In this sense of materialism, his view of wealth is that it only embraces those things that can be and are brought to the market, and subsequently that an increase of wealth takes place only whenever there is an increase in such things as command exchange values.

But would it not seem to be that Smith confuses production and productive power? The above deals with the negative side of his book. What, then, is his positive statement? The wealth of a nation depends on two entirely different things: first, the ratio that 'productive' labour bears to 'unproductive' labour in the society concerned; secondly, the productivity of the 'productive' labour in that society. On the second issue, enough has already been said. On the first issue, however, Smith admits that some types of the so-called 'unproductive' labour are useful and indispensable to society, e.g., university teaching. But the majority of this type of labour, he maintains, is nothing but a waste of resources, for 'productive' labour produces wages as well

as profits, whereas 'unproductive' labour produces wages only. This argument, however, is not impressive, for the simple reason that the former type of labour is combined with capital in order to produce the final product, the manufactured article, whereas the second type is working on its own without the assistance of capital in order to produce the service.

This distinction was firmly established from that time until the end of the nineteenth century, which marked the emergence of the neoclassical school of thought based on marginalism. The leaders of this school then laughed at the idea and demolished it. The marginalists have asserted that no distinction exists between goods and services in the circle of exchange so long as both types of commodities command utility to consumers. Nevertheless, might it not sometimes seem, in the light, not of abstract reasoning, but of historical and factual evidence, that there is a grain of truth in the Smithian distinction between the two types of labour? Colin Clark provides the answer to this question by stating that one of the reasons for the backwardness of under-developed countries is that domestic and menial service constitute a high proportion of the labour force in those countries. A concrete example exists in the case of Jamaica. While the population there has doubled itself, it seems that almost the same number of workers are engaged on the farms, and the surplus population has been driven to domestic service. This implies that a large part of the working population is engaged in occupations where no real production obtains in the

sense that the total output of the country would not significantly be reduced if the domestic service were prohibited or diminished. This surplus could have been absorbed in manufacturing industry had there been enough capital formation to work with.

Another point characteristic of Adam Smith is his emphasis on parsimony as the real basis of the accumulation not only of private wealth but also of the wealth of nations. In his view, capital accumulation should be attributed to parsimony rather than to industry. This proposition goes along the traditional lines of encouraging the Saving Movement - by declaring that every spendthrift is a public enemy and every saver is a public benefactor. Thus Smith seems to urge people all the time to save their earnings rather than to spend them unwisely as, for instance, on domestic service, and to attach great importance to the conversion of 'unproductive' labour into 'productive' labour by way of saving and investment. But Smith seems not to go far afield and investigate what are the stimulants to savings. Would it be nation-wide political propaganda, or forced savings by fiscal measures or even tax reliefs on useful investment projects or otherwise? Smith fails to refer to any saving policy as such; he simply tells us that if people save a part of their earnings and if there are investment outlets to absorb these domestic savings, the national income and the level of employment will always be on the upgrade.

A further point characteristic of Adam Smith is his emphasis on consumption. "Consumption," he says, "is the sole end and purpose of all production, and the interest of the producer ought to be attended to only so far as it is necessary for promoting that of the consumer."⁽¹⁾ By consumption is to be understood not only the consumption of private individuals, the benefit of which is limited to themselves, but also the consumption of government services the benefit of which is in no way discriminate. By consumption is also to be understood not only consumption now but also consumption in future. It has sometimes been made a reproach in the Classical tradition that, in making consumption the end of economic activity, Adam Smith and his followers ignored the necessity for creating productive power. But the distinction between productive and unproductive consumption well recognised in Smith's writings and the importance he attached to accumulation were in fact designed to reinforce the emphasis on productive power.

Once it has been established that consumption is the end of economic activity, it was then the specific contribution of Smith and other classical economists that, for the achievement of this end, they recommended the so-called System of Economic Freedom. Given a certain framework of law and order and certain necessary public services, the object of economic activity was conceived to be best attained by a system of spontaneous co-operation. As consumers, the citizens should be free to purchase what they best

(1) Adam Smith, *Wealth of Nations* (Cannan's edition), Vol. ii, p. 159.

satisfy their fancy. As producers, as workers or as owners or organisers of the factors of production, they should be free to use their labour force or their property in such wise as would maximise the reward they receive in money or satisfaction. It is this impersonal mechanism of the exchange market that would bring it about that the interests of the citizens as a whole are harmonised. The individual who intends only his own gain is led by an invisible hand to promote an end which is no part of his intention. It then follows that it should be the chief aim of policy that where obstacles to this spontaneous co-operation exist, they should be swept away. It was in this spirit that, in the world of practice, Adam Smith and his followers addressed themselves to agitation against the main forms of these obstacles: against the privileges of regulated companies and corporations, against the law of apprenticeship, against restrictions on movement and against restraints on importation.

It was in this spirit, too, that, in the fourth book of his *Wealth of Nations*, Smith bitterly criticised the mercantilist doctrines. It was here indeed that the full argument for a free trade policy was developed. Smith conceived of gold and silver not only as commodities devoid of all superior qualities, but also as commodities genuinely subordinate to other commodities. If therefore foreign trade is not pursued for the ultimate end of the acquisition of gold and silver, what will then be the gains to the country from extending its commercial activities to the outside

world? Smith answers this question by reference to two distinct gains. Foreign trade carries out the surplus produce of the country; this is one benefit. The other is that it brings back other commodities for which there is a home demand but no home supply, or at least a deficient one. For Smith, foreign trade is nothing but an extension of domestic trade; and it brings in its train an extension of the division of labour, an increase in specialisation and a multiplicity of exchanges. Related to Smith's free trade argument is his denial of the 'infant' industry argument. For him, the premature development of 'infant' industries, which fail to thrive but for state protection, would bring forth a reduction in the level of saving, employment and national income. This argument, however, seems to be somewhat obscure and difficult to grasp.

It is noteworthy, in this respect, that Adam Smith never conceived the system of economic freedom as arising in vacuo or functioning in a political system so simple and so minimal as to be restricted to the functions of the night watchman. There must be an adequate framework of law and order for this system. According to Smith, the state has three functions, "first, the duty of protecting the society from the violence and invasion of other independent societies; secondly, the duty of protecting, as far as possible, every member of the society from the injustice or oppression of every other member of it; and, thirdly, the duty of erecting and maintaining certain public works and certain public institutions,

which it can never be for the interest of any individual, or small number of individuals, to erect and maintain; because the profit could never repay the expense to any individual or small number of individuals, though it may frequently do much more than repay it to a great society."⁽¹⁾ work.

It is interesting to compare this formulation of the functions of the state with the formulation which is found in Keynes' pamphlet, 'The End of Laissez-Faire'. "The most important agenda of the state", says Keynes, "relate not to those activities which private individuals are already fulfilling, but to those functions which fall outside the sphere of the individual, to those decisions which are made by no one if the State does not make them. The important thing for government is not to do things which individuals are doing already, and to do them a little better or a little worse; but to do those things which at present are not done at all."⁽²⁾ This formal similarity in fact indicates the essential continuity of thought in the tradition of economic liberalism concerning the positive nature of the co-operation between the state and the individual. But it should not be considered that the content of Smith's agenda was limited to the provision of such public utilities as roads, canals and harbours, utilities which embraced the whole sphere of activities affording indiscriminate benefit. Smith made the most powerful plea for popular education and indicated that, had

(1) Adam Smith, *op.cit.*, Vol.II, pp.184-5.

(2) J.M. Keynes, *The End of Laissez-Faire*, pp.46-47.

he known of any available technique, he would have favoured health legislation. (1)

Such is Adam Smith's contribution to the theory of economic policy. Say, Rae and List, however, represent the well-defined lines of criticism of his work. According to Say, "Smith has taken infinite pains to explain how it happens that civilised communities enjoy so great an abundance of products, in comparison with nations less polished, and in spite of the swarm of idlers and unproductive labourers, that is to be met with in society. He has traced the source of that abundance to the division of labour; and it cannot be doubted, that the productive power of industry is wonderfully enhanced by that division; but this circumstance alone is not sufficient to explain a phenomenon that will no longer surprise, if we consider the power of the natural agents that industry and civilisation set at work for an advantage."

'From this error, Smith has drawn the false conclusion that all values produced represent pre-exerted human labour or industry, either recent or remote; or, in other words, that wealth is nothing more than labour accumulated; from which position he infers a second consequence equally erroneous, viz. that labour is the sole measure of wealth or of value produced.'

'This system is obviously in direct opposition to that of the Economists of the eighteenth century, who on the contrary, maintained

(1) C.f. Adam Smith, *op. cit.*, Vol.II, p.272.

that labour produces no value without consuming an equivalent; that, consequently, it leaves no surplus, no net produce; and that nothing but the earth produces gratuitous value, - therefore nothing else can yield net produce Now facts demonstrate that values produced are referable to the agency and concurrence of industry, of capital, and of natural agents, whereof the chief, though by no means the only one, is land capable of cultivation; and that no other but these three sources can produce value, or add to human wealth."⁽¹⁾

Rae, on the other hand, shows how fundamental to Smith's thinking is the notion of an identity between individual and national wealth, and that he connects his analysis with public policy. Rae in fact puts forward Smith's case as follows: "The axiom which he brings forward, that the capital of a society is the same with that of all individuals who compose it, being granted, it follows that to increase the capitals of all the individuals in a society is to increase the general capital of the society. It seems, therefore, also to follow that as every man is best judge of his own business and of the modes in which his own capital may be augmented, so to prevent him from adopting these modes is to obstruct him in his efforts to increase his own capital, and to check the increase of general capital; and hence, that, as all laws for the regulation of commerce are in fact means by which the legislator

(1) Jean Baptiste Say, A Treatise on Political Economy, Book I, Chapter 4, 'Of The Natural Agents That Assist in The Production of Wealth, and Speciality of Land.'

prevents individuals conducting their business as they themselves would deem best, they must operate prejudicially on the increase of individual and so of general wealth."⁽¹⁾

Rae rejects the whole scheme. It is not true, he says, that social and individual interests are identical; nor that the causes that give rise to wealth are the same in the two cases. An individual may gain wealth by way of gambling and tricky bargaining, and factual evidence shows that self-interest does not always lead to increased national wealth. Moreover, while it is generally true that an individual can find employment, and so obtain an income from which he can save, in the case of a nation the materials on which the national industry may be employed are to be provided, and often are or may be wanting. Individuals generally increase their capital by obtaining a larger portion of the common stock. One grows rich, while another grows poor; but while this being so, the national capital itself may remain but little changed. In other words, as individuals generally grow rich by acquiring a larger and larger portion of wealth already in existence, nations do so by the production of wealth that did not previously exist. The two processes differ in the fact that the one is an acquisition of wealth, whereas the other is a creation of it.

It is then a consequence of his views as to the distinction between individual and national capital that Rae assigns to

(1) John Rae, *The Sociological Theory of Capital*, p. 380.

invention a place of primary importance in his scheme of things; and his work is substantially a study of the place of invention in social development. He argues that the creation of wealth is largely dependent upon inventions; and national wealth, as distinct from individual wealth, can only be increased through the aid of the inventive faculty. Thus the power of inventions plays a leading part in his thought; and in this sense he is anticipating J.A. Schumpeter, whose theory of economic development is essentially based on the emergence of innovations. Moreover, the fact that private accumulation rests very largely, according to Rae, on mere acquisition rather than creation of wealth implies further that there is in no way any natural identity between national and individual interests. In harmony with this idea, Rae rejects a strong tendency of the Classical school by holding that there is no presumption against state interference, and that the legislator may, by means of a small expenditure, effect an increase in the productive powers of the community. It is this tendency in Rae's work towards the extension of the scope of state interference for the sake of public good that economic historians usually speak of Rae as the anticipator of the German economist, Friedrich List.

Rae also criticises Smith's treatment of division of labour, holding that it springs from invention rather than the reverse, and hence is effect rather than cause of increased productivity. Although there seems to be an element of truth in Rae's emphasis

on inventions rather than on division of labour, in reality the two are interrelated, each being now cause and effect.

However, a more deliberate line of attack was made by List on the Classical school; it was the neglect of the national element in Political Economy. Adam Smith and his followers had extended their investigations to the whole world. In List's opinion, Political Economy ought to have reference to the life of a nation. Individuals are not only producers and consumers, they are also citizens of states and members of nations; and, moreover, the productive power of all individuals is largely determined by the social and political circumstances of the nation. The function of Political Economy, then, is to accomplish the economic development of the nation.⁽¹⁾

It follows, therefore, that any attempt to keep economics free from politics is mistaken, and that the doctrine of laissez-faire is a sheer fallacy. "The necessity for the intervention of legislative power and administration," says List, "is everywhere more apparent the further the economy of the nation is developed."⁽²⁾ Laissez-faire is a maxim which sounds no less agreeable to robbers, cheats and thieves than to the merchant.⁽³⁾ It is not the function of the statesman to do nothing. "A statesman will know, and must know how the productive powers of a whole nation can be awakened, increased, and protected, and how, on the other hand,

(1), Friedrich List, *The National System of Political Economy* (translated by Samson S. Lloyd, 1904).

(2) *Ibid*, p. 139.

(3) *Ibid*, p. 208.

they are weakened, laid to sleep, or utterly destroyed."⁽¹⁾

How, then, is the task of the statesman to be accomplished? The answer brings us to what is perhaps the central point in List's doctrine. Smith emphasised the advantages of division of labour as applied to any individual trade, e.g., pin-making; but he had no perception of the division of labour as applied to a whole nation, in which case the principle of the division of labour would mean the symmetrical development of all the nation's productive powers. "The popular school," said List, "inasmuch as it does not duly consider the nature of the powers of production, and does not take into account the conditions of nations in their aggregate, disregards especially the importance of developing, in an equal ratio, agriculture, manufactures and commerce, political power and internal wealth, and disregards especially the value of a manufacturing power belonging especially to the nation and fully developed in all its branches."⁽²⁾

This is the text on which List preaches for the encouragement of manufactures. He constantly stresses the point that agriculture, trade and other economic activities flourish only when manufacturing industries have reached a high stage of development. A nation which is predominantly agricultural lacks the most essential division of operations among its inhabitants, and may not acquire even an infinitesimal part of the material wealth of the perfect nation.

(1) Ibid., p. 284.

(2) Ibid., p. 114.

A nation which carries on agriculture alone is like a crippled individual, for in such a nation there would prevail dullness of mind, awkwardness of body, obstinate adherence to old nations, customs, methods and processes, want of culture, of prosperity, and of liberty. It is indeed only under the influence of manufactures that agriculture itself is to be fully developed and raised to a skilled industry.

Against this background of theory based upon the concept of a political and national economy, List indicates the functions of the State. In broad terms, it is crucial to promote the productive powers of the nation, and in the case which List had particularly in mind, from the purely agricultural state to the state combining agriculture and manufactures. In his complete statement, there are five stages of development through which a nation has to pass, and these he describes under the names of original barbarism, pastoral condition, agricultural condition, agricultural manufacturing condition, and agricultural manufacturing commercial condition. The primary weapon whereby a nation may progress from a lower to a higher stage of development is protection in one form or another; but the common view that List is a strong supporter of Protection is as mistaken as giving the impression that Adam Smith was an uncompromising free-trader. List, it is true, lays emphasis on protection, because he is primarily concerned with the stage at which, in his view, protection is most appropriate. But, in a

complete statement of his theoretical exposition, List is properly to be described as being neither a protectionist nor a free trader. Neither policy is for him an end in itself; each is merely a means, and the appropriate policy will depend on the needs of each case. In the earlier stages, nations will adopt Free Trade with more advanced nations as a means of raising themselves from a state of barbarism, and of making advances in agriculture; in the next they will promote the growth of manufactures, fisheries, navigation and foreign trade by means of commercial restrictions; and in the last, when they have reached the highest degree of wealth and power, they will revert to the principle of Free Trade in order to preserve their agriculturalists, manufacturers and merchants from indolence.

It will be observed, therefore, that, for List, Protection is but a transitional phase from one stage of economic development to another. In this respect, he appears to be overwhelmed with a nationalistic spirit preaching for the doctrine that 'Germany must care for Germany and Russia for Russia.' Yet, elsewhere, he appears to be looking into the future when the union of all nations will have become a reality. Protection, according to List, is indeed the most efficient means of furthering such a union, and hence true freedom of trade, when all nations will have reached the highest stages of economic development.

2. JOHN STUART MILL.

Although J.S. Mill (1806-1873) added little to economic theory, his formulation and exposition of the doctrines of his predecessors, together with applications and illustrations, was such that his famous work represented the most intelligible transition from classical political economy to neo-classical economics. (1)

Mill distinguishes national or social wealth from individual wealth, and defines it as "all useful or agreeable things which possess exchangeable value." He adds that the essential qualities of wealth are a material nature and susceptibility to accumulation. He attacks mercantilist ideas, explores the various economic stages of society as he sees them, and investigates the great inequalities in wealth among different nations, attributing those inequalities, partly to the laws of production which are natural and not arbitrary, and partly to the laws of distribution which are largely influenced by human institutions and hence are in fact arbitrary.

In Mill's opinion, the whole question of private property, as a social institution, is at bottom one of utility. If any other system could be shown to minister to the happiness of society as a whole better than the system of private property, this system should no doubt be adopted. But which system carries with it a greater amount of total net happiness? The answer to this question

(1) John Stuart Mill, Principles of Political Economy.

is the solution of the problem; and it should imply the consideration of historical experience, all motives which influence men under different social systems, and all effects of society on the individual and of the individual on society.

The right of property, which one enjoys in the fruits of one's labour, exists only by support of the authority of society, and this support can be withdrawn. Now if the right of property in that which one has created is of this nature, how much more dependent must be the right of property in land, which nature, not man, created? Here private property is justifiable only if landlords make those improvements which would benefit society. The state should invariably reserve and exercise the right to interfere when the public good demands it. The fact that land is limited both in quantity and quality gives the state this right, which it ought to have in case of all monopolies. In fact Mill here recommends various measures to encourage improvements on land, small holdings, and the cultivation of waste land. He even goes further in the formulation of his economic policy to express the view that it might be advisable for the state itself to own land and lease it to co-operative agricultural associations, or in small portions to individual peasants.

It is sometimes believed that Mill would prefer Communism to an unimproved state of our present capitalist system. But the choice does not lie between Communism and the continuance of our

present state without improvement. According to Mill, the first measure to be introduced is universal education. The workers lack the means and the will to provide for the education of their class. The state must care for the schools, and the education should be thoroughly practical in its nature, aiming at developing sound common sense, good judgment and an understanding of surrounding circumstances. Moreover, a participation in political affairs is considered by Mill to be an important and necessary means of educating the people. Every adult should have the right of suffrage, under the sole condition of demonstrating that he has improved the advantages of education offered him. Taking an active part in politics is the first condition to accustom the mind to more extended interests and views than those which are only personal. It is, indeed, the first step taken outside of individual and family selfishness.

Such is the way Mill looks at the society, in which the human race can live happily together and maximise their well being and welfare. His policy for social and political reform is impressive and ingenious. He proposes such measures as universal education, universal suffrage and emancipation of women. He recommends the promotion of agriculture by all means, e.g., the re-organisation of the productive units, security of tenancy by lessees, the tillage of all waste land, and the creation of a class of small proprietors by handing over the public land to industrious people. In a nutshell, Mill's real contribution to economic policy seems to

lie in his enlightening discussion of the ways in which the legal framework can be so formulated as to govern economic activity in the best interests of society. And, above all, Mill states with clarity and ingenuity that the property rights should not have come into being but for the protection of society, and as a corollary these rights should be subject to the authority of the state in seeing to it that the property in land is administered in the best interests of society as a whole.

Along this line of thought, therefore, we may see in Mill's writings all the signs of a moderate socialism, the principles of which can be said to be accepted by public opinion in almost all capitalist societies at different stages of development. Besides, his attitude to Communism becomes pretty clear in the last edition of his 'Principles', in which he declares that whatever economic system actually achieves the high ideals of a happy society and a utopian state of things is justifiably acceptable to all. As to Communism, in particular, he sets out two requirements for its adoption. The first is that a Communist regime should carry with it the achievement of high ideals of maximisation of social welfare in the utilitarian sense; but this test is highly impractical, requiring a great deal of historical evidence and concrete facts. The second is that, under a Communist regime, there should be a huge fund of moral and intellectual abilities at the top to administer with efficiency a huge totalitarian state. But this requirement, too, is almost impossible of fulfilment. Human nature

is susceptible to abuse, to lust for power and corruption; and it is no wonder that, under a totalitarian state, the natural rights of man as a free citizen are entirely frustrated. This political aspect is evidently no less important than the economic aspect of Communism. It is then much more advisable to try to improve and re-organise our capitalist society from above in such a way as to get rid of its evils of inequalities, monopolies, crises and poverty rather than to run the risk of putting the destiny of human society and all its noble elements and social values under the dictatorship of a handful of men, whose despotism may be enlightened or completely disastrous to our race. To the unbiased critic, this seems to be the genuine interpretation of Mill's opinion on the 'Social Question'. Such an interpretation is essentially a challenge to the allegations sometimes made that Mill is much more of a Marxian than a Ricardian.

Nevertheless, the improvement and the re-organisation of our capitalist society would necessarily imply that there should be a certain authority charged with the task of bringing such a social reform into effect. Evidently it is not the individual citizens separately but collectively, who can perform this task: it is the State pure and simple. Does not this mean that, by implication, Mill abandons the Smithian doctrine of laissez-faire based on the physiocratic beliefs in the natural laws, rights and liberties of man in his social conduct? Does not this mean that Mill favours

(2) *Ibid.*, Book V, Chap. 2, Sec. 3.

(3) *Ibid.*, Book IV, Chap. 2, Sec. 4.

that the State should transcend its traditional functions as a watchdog, keeping order and justice in an atmosphere of pure individualism?

In fact, Mill remained an individualist, and even his socialism is moulded in individualistic ideas. The reforms which are dear to his heart, the extension of peasant proprietorship and the fusion of labour and capital in a system of co-partnership, are essentially of an individualistic character. When he speaks of legislation that favours equality of fortunes, he openly qualifies his proposed reform by adding: "so far as is consistent with the just claim of the individual to the fruits, whether great or small, of his or her own industry."⁽¹⁾ He looks with disfavour upon progressive taxation as a socialist proposal on the ground that "to tax the larger incomes at a higher percentage than the smaller, is to lay a tax on industry and economy; to impose a penalty on people for having worked harder and saved more than their neighbours."⁽²⁾ In the chapter on Bequest and Inheritance, he is obsessed with the individualistic idea that bequest, as one of the sacred rights of property, must not be frustrated; and he reveals a tendency to favour a system which would "restrict, not what anyone might bequeath, but what anyone should be permitted to acquire, by bequest or inheritance."⁽³⁾ According to Mill, government interference should be limited by a general right of

(1) Ibid., Book IV, Chap. 6, Sec. 2.

(2) Ibid., Book V, Chap. 2, Sec. 3.

(3) Ibid., Book II, Chap. 2, Sec. 4.

citizens to their individuality, in so far as such a right is not injurious to others. Like his classical predecessors, Mill holds that the individual has both a greater knowledge of his own feelings and circumstances, and more interest in his own well-being, than anyone else. Individual initiative is therefore desirable except when it harms other individuals or impedes their efforts to better their position. Individuality, a rich diversity of human development, is the source of all progress. In his essay on Liberty, Mill also shows the dangers of bureaucracy, how it substitutes routine for progressiveness, and how it rushes into ill-advised formulation of policy so long as it is not sufficiently subject to criticism.

Mill, however, allows a great place for government action. If utility is the only test, and if the greatest happiness for the greatest number is thereby to be preserved, then government action is obviously inevitable. Specifically, he would permit state interference in cases in which it is required by the interests of consumers who are unable to help themselves, for here the competition of the market does not apply. State interference is also permissible in the interest of the incompetent, of those under a personal contract in perpetuity, and of those who have but an indirect control over their property, e.g., investors in joint stock companies. There is also room for public activity in cases where people are acting for others and are not properly guided by self-interest as in the administration of charity, or of public

utilities, or in the conduct of scientific research. In such cases, Mill is substantially in conformity with Adam Smith, with the exception that the former as a Classical liberal reveals a tendency in his work towards the extension of the economic functions of the State for the sake of public good.

What distinguishes the Classical liberal outlook, as is exemplified in Mill's work, from the authoritarian system is not a denial of the necessity for state action on the one side and an affirmation on the other, but rather a different view of what kind of action is desirable. The authoritarian has to issue from the centre, or at least from agencies directly controlled from the centre. In contrast to this authoritarian attitude, the Classical liberal does not say that the centre should do nothing. But he believes that the attempt to plan from the centre is liable to break down and that no such plan can be a substitute for truly decentralised initiative. The state, he proposes, shall prescribe what individuals shall not do, if they are not to get in each other's way, while the citizens shall be left free to do anything which is not so forbidden. To the one is assigned the task of establishing formal rules, to the other responsibility for the substance of specific action.

CHAPTER 3.

POPULATION THEORIES

IN CLASSICAL POLITICAL ECONOMY.

1. THOMAS ROBERT MALTHUS.

Malthus (1776-1834) marks indeed a new development in the approach to economic science at the end of the eighteenth century. He attacks the Mercantilist idea that the growth of population is beneficial and socially desirable so long as savings increase. He also attacks the view that savings, when increased, must necessarily add to the national wealth. In Smithian economics the society will be economically progressive if both the stock of capital and population increase in appropriate proportions. Malthus, however comes along to introduce a third factor into this conception of the dynamic development of the economy, viz. the available stock of arable land. This trinity of factors is obviously logical in the production and the increase of wealth, for as J.B. Say emphasises, values produced are attributable to the agency and concurrence of labour, of capital, and of natural agents, and nothing but these three sources can produce value or add to national wealth.

But Malthus differs from other economists in his approach to the laws of economic progress. In his view these laws would inevitably imply a disproportionate rate of increase in population and capital and a continual dearth of land of superior fertility,

with the inevitable result that population would outstrip the means of subsistence. Malthus had to fight the socialists of his day, notably Godwin, who believed in the demand for egalitarian principles, and in the fact that all the social evils would spring solely from the establishment of bad social institutions. Malthus objected to this attitude of Godwin, and stated emphatically that social evils must be attributed not so much to bad social institutions as to the natural law embodying the phenomenon of population.

Malthus starts his analysis of this law by making two postulates upon which to build his population theory: first, that food is necessary to the existence of man; secondly, that the passion between the sexes is necessary, and will remain nearly in its present state. Then Malthus goes on to state that these two laws ever since we have had any knowledge of mankind, appear to have been fixed laws of our nature; and, as we have not hitherto seen any alterations in them, we have no right to conclude that they will ever cease to be what they are now, without an immediate act of power in that Being who first arranged the system of the Universe.⁽¹⁾

These two postulates, being granted, the power of population is indefinitely greater than the power in the earth to produce subsistence for man. Population, when unchecked, increases in a geometrical ratio, whilst subsistence only increases in an

(1) T.R. Malthus, *An Essay on The Principle of Population*, 1798, Book I, Chap. I., 'Outline of The Principal Argument of The Essay.'

arithmetical ratio, and by the very law of our nature which makes food necessary to the life of man, the effects of these two unequal powers must be equal. This implies a strong and constantly operating check on population, arising from the difficulty of subsistence.

The ultimate check to population, states Malthus, appears to be a want of food, arising necessarily from the different ratios according to which population and food increase. But this ultimate check is never the immediate check, except in cases of actual famine. The immediate check may be stated to consist in all those customs, and all those diseases, which seem to be generated by a scarcity of the means of subsistence; and all those causes, independent of this scarcity, whether of a moral or physical nature, which tend prematurely to weaken and destroy the human frame.

Malthus classifies these checks to population, which keep down the number to the level of the means of subsistence, under two general heads: the preventive and the positive checks. The sum of all these checks - vice, misery and moral restraint -, taken together, forms the immediate check to population; and, in every country where the whole of the procreative power cannot be called into action, the preventive and the positive checks must vary inversely with each other. In countries either naturally unhealthy, or subject to a great mortality, from whatever cause it may arise, the preventive check will prevail very little. In those

countries, on the contrary, which are naturally healthy, and where the preventive check is found to prevail with considerable force, the positive check will prevail very little, or the mortality be very small.

Malthus then resorts to factual evidence, after he has propounded his population theory, and finds that in every country some of these checks are in constant operation. However, there are few societies in which there is not a constant tendency in the population to increase, beyond the means of subsistence. This tendency subjects the lower classes of society to distress and prevents any great permanent betterment of their condition. Its effect, in Malthus's view, is to be brought about in the following way. Starting from a situation in which the means of subsistence in any society are just equivalent to the easy support of its inhabitants, the constant urge towards greater population increases the number of people before the means of subsistence are increased. Thus the poor must live much worse, and many of them be reduced to severe distress. The number of labourers will exceed the amount of labour demanded in the market; hence the price of labour must tend to fall, whereas the price of food must simultaneously tend to rise. The labourer therefore must do more work to earn the same as he did before. During this period of distress, the discouragement to marriage and the difficulty of rearing a family are so great that the progress of population is retarded. In the

meantime, the cheapness and abundance of labour encourage the agriculturists to employ more labour on the land, to bring fresh soil under the plough, to adopt intensive methods of agriculture to the already cultivated land, until eventually the means of subsistence become in the same proportion to the population as in the initial situation. The new situation of the labourer, being then again tolerably comfortable, the restraints to population are in some degree loosened, and, after a short period, the same retrograde and progressive movements, with respect to happiness, are repeated. This Malthusian reasoning, relating changes in the size of population to the level of the real wages of labourers, demonstrates the futility of bettering the conditions of the lower classes through any attempted increase in their wages. A pessimistic view as such would cast suspicion upon the possibility of restoring the happiness and felicity of the human race in the present state of society.

Malthus then proceeds to point out that the oscillation implied in his thesis, viz. the alternate retrograde and progressive movements with respect to happiness, will probably not be obvious to common view; and it may be difficult even for the most attentive observer to calculate its periods. One reason why this oscillation is concealed from common view is the difference between the nominal and the real price of labour. It very rarely happens, he says, that the nominal price of labour universally falls; it

frequently remains the same while the nominal price of provisions has been gradually rising. This, indeed, will generally be the case if the increase of manufactures and commerce be sufficient to employ the new labourers that are thrown into the market, and to prevent the increased supply from lowering the money-price. But an increased number of labourers, receiving the same money-wages, will necessarily, by their competition, increase the money-price of corn. This is in fact a real fall in the price of labour; and during this period, the conditions of the lower classes of the community must be gradually growing worse. But the farmers and capitalists are growing rich from the real cheapness of labour. Their increasing capitals enable them to employ a greater number of men; and, as the population probably suffers some check from the greater difficulty of supporting a family, the demand for labour, after a certain period, becomes great in proportion to the supply, and its price of course rises, if left to find its natural level. Thus the wages of labour, and consequently the condition of the lower classes of society, have progressive and retrograde movements, though the price of labour might never nominally fall.

Malthus then shifts his discussion from pure abstract theory and the exposition of its implications in respect of any society, to policy prescription. On that score, Malthus looks with horror at the increase of misery which must necessarily follow the attempts to encourage marriage and population growth. He stresses the fact that, among the lower classes of society, where the point is of

utmost importance, the poor laws afford a direct, constant and systematic encouragement to marriage, by removing from each individual that heavy responsibility, which he would incur by the laws of nature, for bringing beings into the world which he could not support. Malthus thus sees the root cause of poverty not in the establishment of property institutions which would give rise to greater inequalities of earnings between the higher and lower classes, but solely in the natural forces, constantly latent in the human race as a specie of the animal kingdom, which drive man to reproduce himself in a much greater proportion than the means of subsistence allow. He sees, too, that the only way to improve the lot of the lower classes is not to raise real wages of the working people, for this is only a temporary improvement which would eventually give way to the initial situation of distress and poverty, but solely to adopt preventive checks to population growth, and thus by withholding the supply of labour raise its price for an indefinite period. This mode of diminishing poverty is perfectly clear in theory and invariably confirmed by the analogy of every other commodity which is brought to the exchange market.

In this manner, Malthus becomes the first economist to investigate whether the economic system develops its own laws of motion, whether economic progress generates a momentum. Moreover, the Malthusian views on the theory of population were a complete reversal of what was held in the preceding two centuries, especially by the Mercantilists. They went even further than this. For Petty

held that an increase in population was socially desirable on the grounds that it went hand in hand with increasing returns. Smith, too, maintained that an increase in population really meant ampler scope for the application of the principle of division of labour; hence it implied increasing returns. But Ricardo accepted Malthus's theory and inferred that wages in the long run were to be fixed at the subsistence level because changes in population in the manner which Malthus described in his Essay would unavoidably keep wages at that level. Ricardo then took this conclusion as a premise upon which to build up his dynamic theory of falling rates of profit and increasing rents.

However, it is well to pause here and consider John Stuart Mill's position in respect of the Malthusian thesis, for Mill gives a larger place to the principle of population than any other economist of his day. He accepts the thesis and agrees with Malthus in his conception of the preventive and positive checks to population. But he goes farther than Malthus did in the advocacy of preventive checks. This fact is partly to be explained by his strong feeling that women were abused under the existing system. He dwells particularly upon the sin of calling human beings into the world without having the means to support them. He wishes to strengthen the feeling of responsibility in parents, and to spread among the people an understanding of the consequences of over-population. "Poverty, like most social evils," says Mill, "exists because men follow their brute instincts, without due consideration.

But society is possible precisely because man is not necessarily a brute."

A little further on, he makes use of this strong language: "Little improvement can be expected in morality, until the producing of large families is regarded with the same feelings as drunkenness or any other physical excess. But while the aristocracy and clergy are foremost to set the example of this kind of incontinence, what can be expected from the poor? One would imagine that children rained down on married people direct from heaven; that it was really, as the common phrases have it, God's will, and not their own, which decided the number of their offspring."

It is then obvious that Mill favours legislation which must not weaken the feeling of responsibility in begetting children, but must strengthen it. It is in this sense that he explains the ground of his objection to a legal minimum of wages. It would remove all the barriers which now oppose overpopulation, until finally the human race would be so overabundant that it would lead to disastrous consequences to the state of society. Among the lower, as among the higher, classes, the concept of a proper standard of life would be formed and the increase of population would thereby be limited. Besides, if public opinion were once far enough advanced to allow it, legislation could make it a legal offence for one to beget children without having the means to

support them. But Mill thinks that such a law would be unnecessary, if only women were emancipated so that they should not depend for their living upon the exercise of a single physical function. Becoming more independent, they would not submit to the burden of large families. In this sense, Mill preaches for birth control and moral restraint before and after marriage in order to stave off distress and poverty.

But if Malthus's theory was received with the utmost respect, and met with widespread acceptance by such leading writers in classical economics as Ricardo and J.S. Mill, one may wonder whether, in the light of historical evidence during the period between 1798, the date of the publication of his Essay, and then, his theory has been testified to be true or not.

The first criticism of Malthus' theory is to be levelled against the reliability of his postulates. He considered that the chief evidence for the geometrical increase in population was the experience of North America where the usual checks to population had not been operating, so that the postulate might be regarded as based on extrapolation from population trends in that part of the world. His second postulate, the arithmetic increase of means of subsistence was also a case of simple extrapolation on the basis of past trends in Great Britain. It was therefore in flagrant contradiction to past trends in North America and, perhaps, conflicted with the opinions of agricultural experts. However, the concrete conclusions of the theory stood or fell by the

reliability of the method of extrapolation. Exponents of Malthus attempted to support the results of simple extrapolation by an appeal to contemporary theories of agriculture. The principle of diminishing returns from agriculture became the principle prop to the assumption that food production could not expand so rapidly as population would, if unchecked. In its 'static' form, this principle suggested that additional food production could be obtained only by the extension of agriculture on inferior soils or the intensified cultivation of land already utilised. In either case, production would not increase proportionately to the number of workers engaged. Taking a 'dynamic' view, however, it was necessary to consider the possibility of technical improvements enabling increased production to be obtained from any given piece of land or providing access to 'new' land superior to that already under cultivation. Even simple extrapolation from the past progress of agricultural science gave results inconsistent with the 'dynamic' principle of diminishing returns. Attempts to retain the principle often took the form of assertions that future improvements could not be expected on the same scale as in the past.

The second criticism is levelled against Malthus's assertion of the way in which social and economic forces affect the reproduction rates. He states that in most countries, among the lower classes of people, there appears to be something like a standard of wretchedness, a point below which they will not continue to marry and propagate their species. This standard varies

from one country to another, and is formed by various concurring circumstances of soil, climate, government, degree of knowledge, civilisation, etc. The principal circumstances which contribute to lowering it are despotism and ignorance; and those which contribute to raising it are liberty, security of property, the spread of knowledge and a taste for the conveniences and comforts of life. (1)

There seems to be nothing wrong with this exposition of the effect of social forces on population changes. What is really subject to much criticism is the contention that, once such a standard of wretchedness is set in the society, economic forces affect population in such manner that both the population change and the change in real earnings of the working class would go in the same direction; both upwards or both downwards. For the history of the last two centuries suggests that where resources are adequate, production can increase more rapidly than population, so that the standard of living may rise even though population is growing rapidly. And, where this happens, the combination of a rising standard of living and of the new modes of life associated with economic development, causes the birth rate to fall, until it reaches the point at which the population may for a while be stable, or may even fall. This empirical evidence evidently runs counter to what Malthus proposes in his theory; for at certain stages of

(1) T.R. Malthus, *op.cit.*, 2nd Edition, London, 1803, p.557.

economic development, a rising level of real wages and a rising living standard are realistically concomitant with a falling birth rate, not a rising birth rate as is implied in Malthus's theory.

It is tempting, however, to defend the validity of Malthus's theory by investigating, at the same time, both the economic and social forces which influence the development of population. In its 'static' form, therefore, the theory suggests that a raising of the level of real wages of labour above the standard of wretchedness, which is already defined and established by social values, tends to push up the natural increase in population; similarly, any lowering of that level below the conventional standard tends to slow down the natural increase. In its 'dynamic' view, the theory would take account not only of the economic forces, which constantly play the same part in any period of time, but also of changes in social values and forces which take place over time. These changes dynamically tend to raise up the standard of wretchedness in the Malthusian sense, and thereby more than counterbalance the effects of economic forces.

But Malthus does not stop at the point of tracing the causes which practically keep down the population of a country to the level of its actual supplies, but goes on to investigate the causes which chiefly influence these supplies or call forth the powers of production into the shape of increasing wealth. Such an interesting issue is raised and elaborately discussed in his 'Principles'.

"Many writers", says Malthus, "have been of opinion that an increase of population is the sole stimulus necessary to the increase of wealth, because population, being the great source of consumption, must, in their opinion, necessarily keep up the demand for an increase of produce, which will naturally be followed by a continued increase of supply."

"That a permanent increase of population is a powerful and necessary element of increasing demand, will be most readily allowed; but that the increase of population alone, or, more properly speaking, the pressure of population hard against the limits of subsistence, does not furnish an effective stimulus to the continued increase of wealth, is not only evident in theory, but is confirmed by universal experience. If want alone, or the desire of the labouring classes to possess the necessaries and conveniences of life, were a sufficient stimulus to production, there is no state in Europe, or in the world, which would have found any other practical limits to its wealth than its power to produce; and the earth would probably before this period have contained, at the very least, ten times as many inhabitants as are supported on its surface at present."⁽¹⁾

It is obvious, in theory, that an increase of population, when an additional quantity of labour is not demanded, will soon be checked by want of employment, and will not furnish the required

(1) T.R. Malthus, Principles of Political Economy, 1820, 'On The Immediate Causes of The Progress of Wealth'.

stimulus to an increase of wealth proportioned to the power of production. If any doubts, Malthus emphasises, should remain with respect to the theory on the subject, they will surely be dissipated by a reference to experience. Evidently the only way by which one can appraise the practical effect of population alone as a stimulus to wealth, is to refer to those countries where, from the excess of population above the means of subsistence, the stimulus of want is greatest. If in these countries, which still have great powers of production, the progress of wealth is very slow, we have certainly all the evidence which experience can possibly give us, that population alone cannot create an effective demand for wealth.

Malthus then turns to discuss the possibility of saving from revenue to add to capital, considered as a stimulus to the increase of wealth. No permanent and continued increase of wealth can take place without a continued increase of capital accumulation. But, meanwhile, he is inclined to enquire what is the state of things which generally disposes a nation to accumulate; and further, what is the state of things which tends to make that accumulation the most effective, and lead to a further and continued increase of capital and wealth.

First, he holds that commodities should not only be compared and exchanged with each other, as if they were so many mathematical figures, but must be referred to the numbers and wants of consumers.

He disagrees, in this connection, with Say and Ricardo who both hold that although there may easily be a glut of particular commodities, there cannot possibly be a glut of commodities in general. Production being thus the sole source of demand, an excess in the supply of one article merely proves a deficiency in the supply of some other, and a general excess is impossible. Malthus challenges this proposition by reference to the fact that if we compare commodities, as we certainly ought to do, with the numbers and wants of consumers, then a great increase of produce with comparatively stationary numbers and with wants diminished by parsimony, must necessarily occasion a great fall of value estimated in labour, so that the same produce, though it might have cost the same quantity of labour as before, would no longer command the same quantity, and both the power of accumulation and the motive to accumulate would be strongly checked.

Further, a healthy taste for luxuries - a taste which will properly stimulate industry - is one of the things which generally disposes a nation to accumulate. But the history of human society shows that the development of this taste for luxuries is culturally of slow growth, and that it is a most important error to take for granted that mankind will readily produce and consume, and will never prefer indolence to luxuries and the rewards of industry.

Finally, Malthus imposes the condition that the conversion of revenue into capital should be kept within the appropriate

limits. If the conversion of revenue into capital is pushed beyond a certain point, it must throw the working classes out of employment as a result of diminution in effective demand. Hence the adoption of parsimonious habits, in too great a degree, may be accompanied by the most distressing effects at the outset as well as by a permanently marked depression of wealth and population.

The Malthus-Ricardo controversy over the saving problem emerged out of the conditions of the time. There were import duties on corn, and these raised a debatable issue between the industrialists, on the one hand, and the landowners on the other. Ricardo was the champion of the repeal of Corn Laws. He believed, rightly or wrongly, that the landowners were usually lazy and apathetic, and they often spent their incomes on things which were in no way productive. By contrast, the capitalists were energetic and thrifty, and their increased incomes were saved and invested. Malthus, however, refuted this argument. He was in favour of the Corn Laws. He accepted the view that landowners are usually the consumers while the capitalists are the savers; but he doubted very much that the national income would increase as a result of increased savings.

In Malthus' opinion, savings are invested in fixed capital for furthering the production of consumable goods. Thus an increase in savings would ultimately bring forth an increase of the output of final products. After all, consumption in the Classical tradition is the ultimate end of all economic activities.

But it would only be possible for the producers of final products to dispose of the increased output in the commodity markets if, and only if, there was a corresponding increase in effective demand. The crux of the problem is therefore the creation and maintenance of this effectual demand. If the demand is there, the capital will be forthcoming. But the contrary is not always true. If the capital is there, the demand will not necessarily be forthcoming. Foster the demand, and the capital will look after itself. Should not this Malthusian line of thought be regarded as the prototype of what is technically known as the acceleration principle in modern economic analysis?

In real life, Malthus goes on, we may find countries abounding in natural resources, with open land with high fertility. Nevertheless, the peoples of those countries actually live in abject poverty and enjoy but a low standard of living. Malthus explains this backwardness by reference to the fact that those peoples are actually indolent and apathetic, that their conventional habits and mode of life are such that they are contented with bare necessities, and their standard of wretchedness, so to speak, is so low that effective demand is correspondingly low. If effective demand in those countries were pushed up, production of goods would be buoyant, and savings and investment requirements would automatically be met.

Malthus then proceeds to discuss ways and means of fostering

demand. First, he commends the expansion of internal and external markets. In regard to home markets, he argues, the best way to effect their expansion is to ensure an adequate number of 'unproductive' consumers, e.g., landowners, civil servants, domestic servants. For that reason, he is against the aggregation of land into large units. If these units were disintegrated, there would be more and more landowners who constitute a major part of the demand for the produce of industry. In view of this, an increased number of landowners, through a change in the legal framework, would produce a greater demand, a larger amount of consumption, and a higher level of employment and a larger national income.

On the same line of argument, Malthus is in favour of the National Debt which performs a useful function in fostering effective demand. If a tax is levied on production in order to finance the debt service, and the tax proceeds then transferred to the bondholders who, in Malthus's view, are largely the 'unproductive' consumers, this would increase effective demand. If the National Debt were suddenly abolished, this would bring forth a great deal of unemployment, resulting from the slackening of demand. From 'productive' to 'unproductive' labour was the slogan in the days of Malthus for maintaining a high level of employment. In our times, the cry is for a transfer from the rich to the poor with a view to increasing the purchasing power in the hands of consumers as one measure of maintaining full

employment. In other words, Malthus was in favour of transferring income from capitalists to consuming landowners in order to increase effective demand; and this is contrasted with the Ricardian advocacy of transferring income from landowners to capitalists for the sake of increasing saving and investment. of money is in the

Jean Baptiste Say represents the well defined line of criticism of Malthus's work. In his 'Treatise', he argues that the belief held by so able an economist as Malthus, that there may be a glut in the market and a general over-production, is entirely erroneous. (1) There can be no such thing, Say observes, for selling is at the same time buying, and in producing, men are creating a demand for other things. Say's idea appears to be more or less a development over the physiocratic teaching that, in buying and selling, goods exchange for goods. For his argument is essentially based upon the assumption that exchange is "barter", but the use of money introduces lags and complications which make so simple an analysis too unreal to be generally applicable. Money performs but a momentary function in any act of double exchange; and when the transaction is finally closed, it will always be found, that one kind of produce has been exchanged for another.

According to Say, a product is no sooner created than it, from that instant, affords a market for other products to the

(1) J.B. Say, A Treatise On Political Economy, Book I, Chap.15,
'Of the Vent or Demand for Product'.

full extent of its own value. When the producer has put the finishing hand to his product, he is most anxious to sell it immediately, lest its value should vanish in his hands. Nor is he less anxious to dispose of the money he may get for it; for the value of money is also perishable. But the only way of getting rid of money is in the purchase of some product or other. Thus the mere circumstance of the creation of one product immediately opens a demand for other products.

But Say goes further in his analytical exposition by explaining that the glut of a particular commodity arises from the fact that it may outstrip the total demand for it in one of two ways: either because it has been produced in excessive abundance, or because the produce of other commodities has fallen short. It is because the production of some commodities has declined, that other commodities are superabundant. Say observes, moreover, that precisely at the same time that one commodity makes a loss, another commodity is making excessive profit. And, since profits must operate as a powerful stimulus to production, there must be some violent means, or some extraordinary cause, a political or natural convulsion, or the avarice or ignorance of authority, to perpetuate this scarcity on the one hand, and consequent glut on the other. No sooner is the cause of this political disease removed, than the means of production feel a natural impulse towards the vacant channels, the replenishment of which restores activity to all the others.

Say's analysis on the above lines has led him to deduce the following four fundamental conclusions: (a) In every community, the more numerous are the producers, and the more various their production, the more prompt, numerous, and extensive are the vents for these productions; (b) Each individual is interested in the general prosperity of all others, and that the success of one branch of industry promotes that of all the others. The division of nations into agricultural, manufacturing and commercial is idle enough; for the success of a nation in agriculture is a stimulus to its manufacturing and commercial prosperity, and the flourishing condition of its manufacture and commerce reflects a benefit upon its agriculture; (c) There is no injury to the national industry and production to buy and import commodities from abroad, for nothing can be bought from foreign producers, except with domestic products which find a vent in world markets; (d) The encouragement of mere consumption is no benefit to commerce, for the difficulty lies in supplying the means, not in stimulating the desire for consumption. Production alone furnishes those means; and it is thus the aim of good government to stimulate production, of bad government to encourage consumption.

According to some authors, there is perhaps in all this nothing very original. Professor Gray, for instance, remarks that the essence of the doctrine can be found in Quesnay's Dialogue du Commerce; nor are the conclusions drawn by Say from the "Loi des Debouches" different from those to be found in Smith or Quesnay.⁽¹⁾ But even if Say was not original in

(1) Professor Sir Alexander Gray, *The Development of Economic Doctrine, An Introductory Survey*, pp. 269-270.

propounding his famous law that supply creates its own demand, his illustrious and elegant exposition of that law justifiably gained for him a famous name in his days.

It was almost a century after its enunciation that Say's law was shown to be frustrated. Say's views on the subject coincide with those of Ricardo who represents the classical tradition that adequacy of effectual demand and full employment of resources normally obtain, except for temporary disequilibrium in the exchange market as a result of institutional forces. Malthus's position, however, is entirely different; but apart from his criticism of Say's work along the lines which are based on abstract reasoning alone, the facts of history themselves condemn Say's theory. The phenomenon that stands out in the history of the capitalist market economy during the last fifty years, is the persistence of cyclical economic instability. It is fully effected in the general trend of contemporary economic thought, and a number of business cycle theories have been expounded in order to explain its persistence in capitalist societies. The recurrence and increasing severity of unemployment, particularly in the 1930's, produced in fact a keener pre-occupation with the analysis of business cycles and a new trend of economic thought that has been associated with the name of J.M. Keynes. This new development in economic theory constitutes a break in the continuity in the classical tradition as exemplified in Say's law of adequacy of effective demand.

population is sup 2. DAVID RICARDO.

It was with economic maladjustments caused by the beginning of the Industrial Revolution and the Napoleonic Wars that political economy turned more and more towards problems of distribution. Whereas Adam Smith was still preoccupied with problems of production, Malthus with problems of population, Ricardo (1772-1823) and his followers regarded the exploration of the laws regulating the distribution of the national product amongst the owners of productive resources as the main theme of political economy.⁽¹⁾

Nevertheless, what is really relevant here is not the exploration of the laws governing the distribution of the national product but the Ricardian dynamic approach to the scheme of distribution, an approach which is substantially based on the Ricardian rent theory and the Malthusian theory of population. But capital as well as population are the two fundamental factors in dynamic analysis, whose introduction into the Ricardian scheme is necessary to draw a clear picture of the dynamic development of the economy. An increase of capital will tend to increase the demand for labour in the longer run. Wages will therefore tend to increase; and, as a result, the checks to population, in the Malthusian sense, will be weakened and the numbers increased. Every increase in

(1) David Ricardo, Principles of Political Economy and Taxation.

population is supposed to drive cultivation out into inferior land, thus raising the rent on the better land which was already under cultivation. On inferior soils an additional amount of labour will be required to produce a given quantity of food, and the price of foodstuffs is therefore increased. Money wages rise subsequently, for wages must cover the subsistence of the worker. Thus when two of the three shares into which the produce is divided increase in money terms, the share going to the agricultural entrepreneurs in the form of profit must at the same time decrease. In real terms, wages remain constant, whereas with rents increasing profits must decrease. According to Ricardo, whenever money wages are increased, profits, with which interest is lumped, must be reduced correspondingly; nothing can affect profits but a rise in money wages. There seems to be no place in the Ricardian scheme for the 'economy' of high wages, or the possibility of changes in the productivity of labour. In the Ricardian scheme, wages and profits are diametrically opposed; the fall in the one means a rise in the other. In the long run, whereas rents and money wages will rise, profits will always tend to fall relatively and absolutely; and when they do they will gradually become too low to support the capitalists. In consequence, accumulation will eventually come to a stop and secular stagnation will be the inevitable outcome.

It then follows that, instead of the old harmony of individual

interests which Adam Smith elaborated and emphasised in his work, we find at the heart of the economic system, according to Ricardo as well as Malthus, antagonisms and inevitable conflict of interests. Ricardo's dynamic scheme of distribution implies a constant clash between the interests of the landlords on the one hand, and those of the consumers and manufacturers on the other. It also implies a permanent clash of interests between the workers and the employers, a clash which is in no way reconcilable. For if one party gains, the other party will necessarily lose. Once again the Smithian optimism has been transmuted into downright pessimism.

In a sense, however, Ricardo was not a Ricardian, for he was always inclined to consider other economists' views. He differed with Malthus in matters of economic policy; the Malthus-Ricardo controversy over the saving problem is an interesting case in point. Unlike Malthus, Ricardo rejected the idea that there could be any deficiency in demand. J.B. Say, as has been pointed out, held a similar view which was vigorously expressed in his famous law that supply creates its own demand.

Nevertheless, concern about deficiency in effective demand is readily recognisable in the chapter devoted to capital in Ricardo's 'Principles', for he points out, in that part of his work, how the introduction of machinery into productive processes might act as a deterrent to employment. His argument is not unambiguous, and it is based on the distinction between fixed and

circulating capital. Fixed capital, he argues, employs fewer men than circulating capital; hence if capital resources are transferred from the latter to the former, this transfer must occasion a reduction in the level of employment. This is the inevitable outcome, he maintains, if the total amount of fixed and circulating capital remains unaltered. But if the total amount of capital is constantly tending to increase, the transfer will not matter much, as it is in this case that the increase in mechanisation will tend to reduce costs and prices. The reduction in prices implies that the consuming capacity of the capitalists is increased; they are thus enabled to save more and invest more on capital equipment. The answer to the Ricardian argument may be that, although the transfer of resources from circulating to fixed capital will tend to reduce the level of employment, this is not the most important element in the situation. Fixed capital comes out of new savings, which in turn should create employment not only in the sense of the number of operatives who will be employed with this type of capital in producing final products, but also in the sense of the number of operatives who must be engaged in producing it. In other words, less additional employment, but not necessarily a fall in the level of employment would be the ultimate result. Moreover, even if this Ricardian argument were accepted, it should necessarily imply that savings, which have always been considered as one of the engines of economic progress, would then be condemned on that score.

Ricardo was attacked from different quarters. His value theory was demolished by the utiliterians. The Malthusian theory of population, which he recognised and introduced into his scheme, was accepted by most people, but not all of them. Carey, for instance, argues that it is by no means true that increased population involves the diminution of wage rates until they are reduced to the subsistence level, and population increase checked through misery, vice and moral restraint. On the contrary, an increase in population gives rise to increasing returns, and this means increased production and increased wealth of nations. Rae, too, attacks Ricardo on the grounds that, in his theory, he neglects the significance of inventions to economic progress.

CHAPTER 4.

THE CLASSICAL AND PRE-CLASSICAL THEORIES
IN RELATION TO THE UNDER-DEVELOPED ECONOMY.

We are now in a position to sum up the classical and pre-classical economic thought in so far as the theory of economic development is concerned.

The Mercantilists were the first to realise that political economy had to concern itself with the nature and causes of the wealth of nations. They regarded wealth as a 'stock' of something; and it was in the form of gold and silver, the main source of a nation's wealth and strength. In the absence of mines of gold and silver, it was therefore their prime policy to foster and develop manufacturing industries and bring about a permanent favourable balance of trade by means of minimising imports and maximising exports of manufactures. It was thus on the cruder mercantilist theories that manufacturing industry and foreign trade were the most important of all economic activities, for they could alone increase the country's wealth. The reduction in imports could be made possible by rendering some of the imported goods unnecessary for home consumption by way of protecting native 'infant' industries as well as bringing in foreign craftsmen who would play an important part in the process of industrialisation. Maximisation of exports, on the other hand, could be achieved by removing all restrictions on exports, except for raw materials, and

by encouraging inventive ability through the establishment of legal rights of patents and statutes of monopoly.

The Physiocrats, however, sought to prove that agriculture alone produced the wealth of the nation; and unlike this activity productive of wealth, all other activities are 'sterile' in the sense that in the former there is a 'surplus' whereas the latter just pay their way. A corollary of this physiocratic view, that agriculture was the sole source of wealth and the real revenue to the nation as a whole, encouragement of agriculture became the chief aim of physiocratic policy. Indeed Quesnay, as the true representative of the physiocratic school, laid much more emphasis on agriculture than on other occupations from the point of view of the generation of wealth. He spoke of wealth as a 'flow' concept rather than a 'stock' concept; and defined it as consisting of the sum total of things necessary for life and in the annual reproduction of such things. On this general view, the wealth of a country should not be judged by a greater or lesser supply of money in its possession; for money is but a sterile riches. He was also preaching for a free trade policy, and in this respect he was evidently speaking with the voice of Adam Smith.

Whereas the Mercantilists attributed the increase of wealth of nations to a favourable balance of trade and a concomitant accumulation of money gold and silver, and the Physiocrats contended that wealth would spring solely from the pursuit of agriculture, whose surplus value is indeed its real wealth, Smith came along to

refute these conceptions of wealth, and argued that the source of all wealth was to be found in labour, and that an increase of wealth would be dependent on its productivity. Division of labour would increase this productivity, permit specialisation in processes of production, and through it the use and development of elaborate machinery. He then proceeded to point out that division of labour would be limited by the extent of the market; and as a corollary all barriers to trade must be broken. He advocated colonisation, and regarded colonies as a source of the supply of necessary raw materials as well as an extension of the home market. Moreover, he brought in his writings the evil legacy of the physiocratic distinction between 'productive' and 'unproductive' labour; but with him the two words had then definite meanings. In his view, 'productive' labour is that which adds value to the raw materials to be worked upon, whereas 'unproductive' labour is that type of labour which, however useful it may be, ends in no increase in value. Smith also laid emphasis on parsimony as the real basis of accumulation not only of private wealth, but also of the wealth of nations. He postulated that consumption was the sole end and purpose of all economic activities; and for the achievement of this end, he recommended the so-called System of Economic Freedom. Given a certain framework of law and order and certain public services, the object of economic activity was conceived to be best attained by a system of spontaneous co-operation. He was thus in favour of free trade; and for him

foreign trade was nothing but an extension of domestic trade; it would bring in its train an extension of the division of labour, an increase in specialisation and a multiplicity of exchanges. It was in this spirit that he denied the 'infant' industry argument. *Political Economy*

J.S. Mill, for his part, distinguished national wealth from individual wealth, and defined it, as consisting of all useful or agreeable things which possessed exchangeable value. His conception of wealth as such has led him to maintain that its essential qualities were a material nature and susceptibility to accumulation. He investigated the great inequalities of wealth among different nations, and he attributed them partly to the natural laws of production, and partly to the arbitrary laws of distribution. He visualised a policy for social and political reform. He proposed such measures as universal education, universal suffrage and emancipation of women and recommended the promotion of agriculture by various means. Mill's real contribution seems to lie in his discussion of the ways in which the legal framework can be so formulated as to govern economic activity in the best interests of society. Above all, he stated with clarity and ingenuity that the property rights should not have come into being but for the protection of society, and as a corollary these rights should be subject to the authority of the state in seeing to it that property, the property in land in particular, is administered in the interests of the community as a whole. Along this line of thought we may thus see in Mill's writings all the

signs of a moderate socialism, rooted in individualistic ideas.

It was largely due to the influence of the Essay on Population by Thomas Robert Malthus that many economists of the nineteenth century were led to the pessimistic conclusions which soon earned Political Economy the name of the 'dismal science'. For the main thesis of the Essay was the discovery of the so-called immutable laws of economic development, viz. a disproportionate development of population and capital along with a steadily increasing dearth of land of superior fertility. Malthus was indeed the first economist to investigate whether the economic system develops its own laws of motion. He conceived that the root cause of poverty was overpopulation; and his reasoning related changes in the size of population to the level of real wages in such a manner that real wages would always be pegged at the subsistence level. It was in this sense that he pointed out the futility of improving the conditions of lower classes except through efforts to check population growth besides increasing the quantity of provisions. Malthus used his literary skill to plead for the 'preventive' checks to the natural increase in population. These checks, which are the least inconvenient to the human race, he considered necessary to supplant the dictates of Nature in disposing of redundant population. However, he seemed to restrict himself to moral restraint only in the sense of deferred marriages. But even late marriages may bring forth devastating torrents of children to such an extent that the redundant population would

increase and what he called the positive checks of vice and misery would reduce humanity to the most horrible state. Thus when it comes to such a practical proposition, Malthus' advice seems to be entirely ineffective. Unlike Malthus, J.S. Mill preached for birth control and moral restraint before and after marriage.

Finally, Malthus in his 'Principles' put great emphasis on fostering and maintaining effective demand rather than on the encouragement of saving and investment; and here he dissented from Ricardo and J.B. Say who both denied that there could be any deficiency of effective demand. In compliance with his own views, Malthus was in favour of the expansion of home and foreign markets, and held that the home market could be extended by increasing the number of the 'unproductive' classes, the consuming landlords and civil servants. On that basis, he favoured any measure which entailed the transfer of income from capitalists to consuming landowners, or which increased the number of landowners at home, in order to increase effective demand, whereas Ricardo advocated the transfer of income from landowners to capitalists in order to increase saving and investment. Thus it was only natural that Malthus was against the aggregation of land into large units, and was in favour of the National Debt which, in his view, would perform a useful function in fostering demand. Malthus's reflections on the saving problem has indeed earned him the reputation of being the Classical economist who, in some respects, anticipated Keynes.

Ricardo, for his part, accepted Malthus' theory of population and inferred that wages in the long run were to be fixed at the subsistence level because changes in population in the manner which Malthus described in his Essay would unavoidably keep wages at that level. Ricardo then took this conclusion as a premise upon which to build his dynamic theory of falling rate of profit and increasing rents. The long run decline in the rate of profit would gradually become too sharp to support the capitalists; hence accumulation would eventually come to a stop and secular stagnation would be the inevitable result.

Such was, broadly, the contribution of the Classical Economists to the theory of economic development. With Adam Smith, Malthus, Ricardo and John Stuart Mill, the structure of Classical Political Economy was, in a sense, complete. On the broader issues, they undoubtedly held certain principles in common: they subscribed to the central thesis of the Wealth of Nations against Mercantilism; they believed in property, free enterprise and economic freedom; they accepted the main drift of the Essay on Population; and the individualistic spirit was notably dominant in their writings. Although they varied greatly in political outlook, they shared a common interest in economic development and social betterment. For good or for bad these men and their ideas are historically important. They exercised a profound influence on public opinion in their days, and were responsible,

directly or indirectly, for many far reaching legislative and administrative changes. It is difficult to understand the evolution of Western civilisation without some understanding of Classical Political Economy. It is also difficult to tackle the so many problems involved in the economic development of backward areas without some reference to the broader theory of policy, based on Smith, Malthus, Ricardo, Mill and Say.

Against each of the various aspects of the classical body of thought, however, reaction was inevitable. In the next generation, critics of the excessive individualism of the classical school denied the assumptions on which Laissez-Faire is based, so that some writers began to advocate Protection while others revealed a tendency towards a more optimistic view of the universe. Rae and Sismondi were led to reject Laissez-faire and to insist that extensive duties rest on the State, List and Müller represented the reaction to nationalism and protection; Carey and Bastiat the reaction to optimism, while the continuation of the classical school may be exemplified by Say, Senior and Cairnes.

Say criticised the Smithian proposition that all values produced represent pre-exerted human labour or industry, either recent or remote, and that wealth is nothing more than accumulated labour. In his view, values produced are referable to the agency and concurrence of industry, of capital, and of natural agents; and no other but these three sources can produce value or add to human wealth. In Rae's scheme, on the other hand, individual and

social wealth are in no way identical: the one is acquisition of wealth whereas the other is a creation of it. On this general view, Rae assigned to invention a place of prime importance in his scheme; and his work is essentially a study of the place of invention in social development. List, for his part, preached for the encouragement of manufactures, and in his work he stressed the point that all other economic activities would flourish only when manufacturing industries would have reached a high stage of development. It is therefore in List's view that the chief function of the State is to promote the productive powers of the nation; and when a nation has to pass from the purely agricultural state to the state combining agriculture and manufactures, the primary weapon is protection in one form or another. But neither a protectionist nor a free trade policy is for him an end in itself; each is merely a means and the appropriate policy will depend on the needs of each case.

This is an all-inclusive view of the classical and pre-classical theories of economic policy in general. It is only natural, at this stage, that one is tempted to think of the extent to which these theories are related to the under-developed economy. This relation can best be understood if the attempt is made to dispense with the purely historical and academic parts of the classical and pre-classical economists' theories and concentrate on those parts which will directly pertain to the study of the under-developed economy, and which will crop up in the later stages of this study in their proper context.

Let us consider first the mercantilist policy of bringing about a permanent favourable balance of trade. In its broadest context, neo-mercantilism is in some respects pertinent to the study of the economics of 'development'. The ability to have large exports and to obtain favourable terms for them is of great importance for all under-developed countries. If the proceeds of exports are substantial and stable, these countries may be able to satisfy their needs of imports of capital goods for development largely out of these proceeds and thus to keep down the volume of foreign savings.

Again the physiocratic concept that agriculture is the sole source of wealth is held to be a sheer fallacy in the light of modern economic analysis. In a sense, however, this concept is directly relevant to the under-developed economy. In such an economy, agriculture is by no means the sole source of wealth, but it is, and will remain, its main source. Economic improvement may call for greater industrialisation as a natural growth, but the most promising field for rapid economic development lies in agriculture. There are no inherent advantages of manufacturing over agriculture, or of agriculture over manufacturing. The arbitrary dogmas of the inherent inferiority of one type of industry over another will result in the squandering of resources and the disappointment of the great masses of population looking forward to be relieved of their abject poverty. On the grounds of historical experience, let us consider what happened in the

original home of industrial development, in England in the eighteenth century. Industrial revolution would not have been possible without the agricultural revolution that preceded it. The latter was based mainly on the introduction of the turnip. The lowly turnip made possible a change in crop rotation which did not require much capital, but which brought about a tremendous rise in agricultural productivity. As a result, more food could be grown with much less labour, and the surplus labour was released for capital formation. The growth of industry would not have been possible without the revolution that took place in agricultural methods and techniques.

The emphasis throughout this part is evidently the contribution that theory can offer to policy - making in the economic field if it is reasonably good theory. The English classical school met the test of relevance very well. It kept in close touch with the matters which the lay public regarded as urgent and important, and it directed its analysis towards those problems rather than towards artificial problems of its own manufacture. The relevance of the procedures of the English classical school, however, was relevance for their own time and country, and therefore not necessarily for other times and for other countries. There are certain respects in which it has become clear, for instance, that the assumptions, the models, they worked with are not appropriate, or at least are not

acceptable, for their own country in our times and for economically less advanced countries at any time."⁽¹⁾

The English classical school, with the sole outstanding exception of Malthus, neglected the short-run phases of economic process and economic policy, and especially cyclical instabilities of employment and income. The growth of the political importance of under-developed countries has rendered unacceptable the classical economics which conducts its analysis chiefly in static terms and overwhelmingly in the light of the conditions and the concerns of the industrially most advanced, the socially most stable, and the economically most prosperous countries. Even the more recent developments in economic and social structure, and in political organisation, make the classical doctrine if left unaltered obsolete, and calls for its adaptation to the new circumstances if not for its outright rejection. The decline of effective competition and of price-flexibility, the growth of central planning on a national scale, the establishment of new international institutions, all operate to create a setting for international economics differing significantly from the nineteenth century setting out of which the classical theory of trade was evolved.⁽²⁾

(1) Jacob Viner, *International Trade And Economic Development*, Oxford, 1953, pp. 4-5.

(2) *Ibid.*, pp. 12-13.

In under-developed areas and in circles in the advanced countries which are specially concerning themselves with the problems of development, there is to-day a large and growing body of doctrine which presents specific challenges to the classical school. However, the writer wishes to stress the fact that there are certain other respects in which the relevance of the classical doctrine to the under-developed economy becomes pretty clear. The classical school operated on the assumption that men acted rationally, that the major economic objective of rational men which required national policy decisions for its fulfilment was the promotion of economic prosperity, and that the major means of attaining that goal was economic liberalism at home and free trade in international commerce. To-day there is in government activities an inherent irrational bias toward autarky. Foreign trade nevertheless survives, and survives to a surprising degree, in spite of the obstacles placed in its way. In part, it survives because the strength in human nature of the basic economic objectives, the search for better commodities at lower costs, for different commodities, for better markets, is great enough to break through in some degree the tightest of restraints on trade.

Besides, it is not without significance to the under-developed economy that Adam Smith expounded his theory of wealth, that labour is the source of all wealth and that division of labour

increases productivity but is limited by the extent of both the internal and external markets. In most under-developed countries, there are many instances of the way in which the small size of the market discourages, or even prohibits, the profitable application of modern capital equipment and the establishment of large-scale industries. In other words, Smith's specific contribution lies in the fact that he provides the key to the solution of the fundamental problem of capital formation on its demand side in the under-developed economy.

The opportunities open to an under-developed country in the foreign trade field are certain to be a vital factor in determining the rate at which it can make economic progress. No country except the U.S.A. has attained a high level of per capita income which has not maintained a high ratio of imports to total national product, and no country except Russia can, in this respect, follow the example of the United States without courting perpetual poverty. But the high degree of self-sufficiency of the United States was mainly due to its continental character, its richness and variety of natural resources as well as the technical skills of its people which enabled her to achieve economic prosperity in spite of its deliberate national policy of high tariff protection and its low ratio of foreign to domestic trade.⁽¹⁾

If from the mercantilists and physiocrats one gets the idea of the relative importance of different types of economic activity,

(1) Ibid., pp. 116.

from Smith the concept of free trade and extension of the market, from John Stuart Mill one can also get the idea of social and political reform. As has been pointed out already, Mill's theory of economic policy is essentially based on universal education, universal suffrage, emancipation of women, security of tenancy, tillage of waste land, promotion of agriculture, and the creation of a class of small proprietors. What else in the classical doctrine can be found to be more pertinent to the study of the under-developed economy? In such an economy, the 'quality' of the working population is indeed of great importance. Labour productivity depends upon historical and cultural factors, upon the quality of health, nutrition, and education, and the quality of the leadership provided by government and the ruling class. The first requirements for high labour productivity under modern conditions are that the masses of the population shall be literate, healthy, politically minded, and sufficiently well fed to be strong and energetic. If this were achieved all else necessary for rapid economic development would come readily and easily of itself. Whenever this has not been achieved, it is not necessary to look for other factors to explain pervasive poverty and slow economic growth.

As for Malthus, he was deeply concerned about the difficulty of raising the masses of the English poor from their level of desperate poverty, because of their tendency, as he believed, to

absorb any increase in productivity in an increase in their numbers instead of using it to raise their standard of living. The fundamental assumption of Malthusianism in the strict sense is the uniform power of increase in population, subject to the preventive checks, i.e., a potential uniform birth rate. But one of the most pronounced features of population statistics is the steady decline in the birth rate in many well-developed countries, and in some of these countries the fear is of depopulation. In most under-developed countries, however, a serious obstacle to the attainment of economic prosperity, in the sense of a high level of per capita income, is associated with a rapid rate of increase of population. In those countries, population increase can offset, perhaps more than offset, the contribution to economic prosperity which all other factors can make. Whatever the opportunities for economic development created by technical progress, by the discovery of new natural resources, by economic aid from abroad, they can have as their main consequence an increase in the number of children who survive to a short and wretched adulthood.

What is most discouraging is that there are no easy and certain remedies for the overpopulation problem, that the remedy, birth control, which to most social scientists appears to be the only promising one requires a fairly high level of education and of income to be widely available and effective. As Viner has

pointed out, it is a paradox of the population problem in under-developed countries that on the grounds of historical experience and of theoretical analysis the attainment of high levels of per capita income and of education appear to be almost essential pre-requisites of a cure of the problem and that the excessive rate of increase of population is itself the most important barrier to the establishment of these pre-requisites. Here once more, the curse of the poor is their poverty; and here again the Malthusian bogey hovers over all poor countries. ⁽¹⁾

(1) Ibid., pp. 118-119 and 101-102.

CHAPTER II

ECONOMIC DEVELOPMENT IN
THE HANSEATIC CITIES

The historical political economy was attacked from two sides. The attack came from the historical school, which refused to consider the capitalist market economy as a natural order, and which regarded such major classical theories as the law of rent, the law of wages, and the law of profit as mere dogmas. It was also attacked from the other side by the Marxists, who regarded the capitalist market economy as a mere dogma, and who regarded the law of rent, the law of wages, and the law of profit as mere dogmas.

PART II

MORE RECENT TRENDS

IN THE THEORY OF ECONOMIC DEVELOPMENT

The study of history, in the opinion of this school, was essentially the only way to understand and explain economic phenomena with clarity and certainty. In fact, the school considered itself with proper justification as a school of historical political economy. The study of history, in the opinion of this school, was essentially the only way to understand and explain economic phenomena with clarity and certainty. In fact, the school considered itself with proper justification as a school of historical political economy.

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CHAPTER 5.

ECONOMIC DESTINY IN
THE MARXIAN SCHEME

Classical political economy was attacked from two sides. One attack came from the historical school, which refused to consider the capitalist market economy as a natural order, and which refuted such major classical doctrines as the wage fund theory, the law of rent and profits and the doctrine of population by reference to 'facts' in terms of statistical data. Thus by the middle of the nineteenth century a different subject came into being, and economic historians set up the historical school in Germany and England. This school assumed a different approach to economics, for it denied altogether the usefulness of abstract reasoning. The study of history, in the opinion of this school, was essentially the only way to understand and explain economic phenomena with clarity and certainty, so that the school concerned itself with making historical studies in order to arrive at economic laws absolutely based on historical facts. In so doing, the school moved out of the field of abstraction, the deductive method of scientific research.

Classical political economy was also attacked by Marxism, which criticised capitalism as a system of exploitation, monopoly and periodical crises ultimately doomed and destined to be

replaced by a system of collectivist planning. Like classical economics, Marxism undertook the analysis of the operation of the capitalist market economy. Like Ricardo, Marx used the method of abstraction and approached reality only in a series of 'successive approximations'. The labour theory of value, which forms the cornerstone of the Marxian system, was not peculiar to Marx. With the exception of J.B. Say, every leading political economist since Sir William Petty had taken for granted that labour is the measure of value. But in spite of this identity of method and central doctrine between Marxism and Classical Economics, Karl Marx arrived at conclusions diametrically opposed to those of the classical school. Instead of harmony of interests, Marx demonstrated the existence of exploitation, the urge to accumulation, the inevitable concentration of property, and the inevitable conflict and struggle between labour and capital. Instead of automatic equilibrium between consumption and production and the economic development of the capitalist society, Marx prophesied recurrent crises and ultimate breakdown of the capitalist order.

Before Karl Marx became a political economist he had been a political scientist and a historian. From the outset he regarded the capitalist order as a historical category which would give way to new forms of economic organisation in accordance with the changes in the economic structure of society. This general world

outlook induced Marx to search for, and arrive at, the revolutionary conclusions which emerged in the Communist Manifesto (1848), and which found their most systematic demonstration in the three volumes of Das Kapital. Unlike most classical economists, Marx never hesitated to carry out the labour theory of value to its logical conclusion. What neither Smith nor Ricardo would admit, Marx states in an explicit way. It is that the price of labour falls short of the labourer's contribution, in terms of value, to the total product. Upon this theory of surplus value is based the whole series of conclusions which together make up the Marxian scheme.

Marx started as a man of vision. He views that historically human society constantly enters into successive stages of evolution and development, that capitalism as a social organisation sprang from feudalism and should in time give way to socialism. In the Marxian view, capitalism is a process by which the proletariat were separated from land and have henceforward become workers, thus ending a status of serfdom. As a man of vision he also distinguishes in a capitalist society, two conflicting classes: bourgeoisie and proletariat. This class war, he urges, is bound to handicap economic progress. In any given society, the strivings of some of the members conflict with the strivings of others. History discloses to us a struggle among peoples and societies, and also within each nation and each society. These contradictions

in social life manifest in addition an alternation between periods of revolution and reaction, peace and war, stagnation and rapid progress or decline. Nothing but the study of the totality of the strivings of all members of a given society, or group of societies, can lead to the scientific definition of the result of these strivings. The conflict of strivings arises from differences in the situation and modes of life of the classes into which society is divided.

The history of all human society, past and present, wrote Marx in the Communist Manifesto, has been the history of class struggles. Freeman and slave, patrician and plebeian, baron and serf, guild-burgess and journeyman - in a word, oppressor and oppressed - stood in sharp opposition each to the other. They carried on perpetual warfare, sometimes masked, sometimes open and acknowledged, a warfare that invariably ended either in a revolutionary change in the whole structure of society or else in the common ruin of the contending classes. Modern bourgeois society, rising out of the ruins of feudal society, did not make an end of class antagonisms. It merely set up new classes in place of the old, new conditions of oppression, new embodiments of struggle. Our own age, the bourgeois age, is distinguished by the simplification of class antagonisms. More and more, society is splitting up into two great hostile camps, into two great and directly contraposed classes: bourgeoisie and proletariat. Among

all the classes that confront the bourgeoisie to-day, the proletariat alone is really revolutionary. Other classes decay and perish with the rise of large-scale industry, but the proletariat is the most characteristic product of that industry. The lower middle class - small manufacturers, small traders, handicraftsmen, peasant proprietors - one and all fight the bourgeoisie in the hope of safe-guarding their existence as sections of the middle class. They are, therefore, not revolutionary, but conservative. Nay, more, they are reactionary, for they are trying to make the wheels of history turn backwards. If they ever become revolutionary, it is only because they are afraid of slipping down into the ranks of the proletariat. They are not defending their present interests, but their future interests, they are foresaking their own standpoint in order to adopt that of the proletariat.

Although Marx started as a man of vision, he became an analytical economist throughout the next forty years, after he had published his Communist Manifesto. He tried in fact to set out a logical system in support of his visionary ideas. In this respect, he has independent views which are entirely his own, particularly in regard to the value theory. Throughout his work, the concept of the surplus value is basic to his scheme, and his attempt to associate the construction and use of machinery with mass unemployment is readily manifest. In this matter, Marx is more Ricardian than Ricardo himself. In other fields of enquiry,

however, he is no more a Ricardian. He completely refutes the Ricardian as well as the Malthusian theories of secular stagnation. He visualises that a capitalist society will not be secularly stagnating, but will inevitably collapse, and on its ruins will be firmly established a 'progressive' socialist society. On the path to this ultimate development of economic organisation, he envisages five successive stages viz., falling rate of profit, capital accumulation, commercial crises, increasing misery of the proletariat, and finally the breakdown of the capitalist system when the expropriators become expropriated.

1. FALLING RATE OF PROFIT.

It is the ultimate aim of Marx's work to reveal the economic law of motion of modern capitalist bourgeois society, and the content of his economic teaching is the study of the production relationships in a given, historically determinate society, in their genesis, their development, and their decay. In capitalist society the dominant feature is the production of commodities, and Marx's analysis therefore begins with an analysis of a commodity. First, a commodity is something that satisfies a human need; secondly, it is something that is exchanged for something else. Exchange value, or simply value, presents itself first of all as the ratio in which certain units of one commodity are exchanged

for certain units of another. What is common in these various commodities, which are constantly weighed one against another in a definite system of social relationships, is that they are products of labour. In exchanging products, people equate with one another, most diverse kinds of labour. The production of commodities, Marx observes, is a system of social relationships in which different producers produce various products (the social division of labour), and in which all these products are equated with one another in exchange. In consequence, the element common to all commodities is not concrete labour in a definite branch of production, not labour of one particular kind, but abstract human labour in general. All the labour power of a given society, represented in the sum total of values of all commodities is one and the same human labour power. Thus each particular commodity represents only a certain part of 'socially necessary' labour time. The magnitude of the value is determined by the amount of socially necessary labour, or by the labour time that is socially requisite for the production of the given commodity. "Exchanging labour products of different kinds one for another, they equate the values of the exchanged products; and in doing so they equate the different kinds of labour expended in production, treating them as homogeneous human labour. They do not know that they are doing this, but they do it." Value can only be understood when it is considered from the point of view of a system of social production relationships in one particular historical type of society; and,

moreover, of relationships which present themselves in a mass form, the phenomenon of exchange repeating itself millions upon millions of times. "As values, all commodities are only definite quantities of congealed labour time." in prices, for mutual exchange

Marx then goes on to discuss the history of the development of exchange and commodity production, beginning with isolated and casual acts of exchange, passing on to the universal form of value, in which a number of different commodities are exchanged for one and the same particular commodity, and ending with the money form of value, when gold becomes this particular commodity, the universal equivalent. "Being the highest product of the development of exchange and of commodity production, money masks the racial character of individual labour, and hides the social tie between the various producers who come together in the market."

At a particular stage in the development of commodity production, money becomes transformed into capital. The formula of commodity circulation is C.M.C. (Commodity-Money-Commodity), i.e., the sale of one commodity for the purpose of buying another. But the general formula of capital, on the contrary, is M.C.M. (Money-Commodity-Money), i.e., purchase for the purpose of selling at a profit. The designation 'surplus value' is given by Marx to the increase over the original value of money which is put into circulation. Because of this 'growth' of money in capitalist society, money is transformed into 'capital', as a special,

historically defined, social relationship of production. Surplus value cannot arise out of the circulation of commodities, for this represents nothing more than the exchange of equivalents. Surplus value cannot arise out of an increase in prices, for mutual losses and gains of buyers and sellers would cancel out; and what is really significant is not what happens to individuals separately, but with a mass or average or social phenomenon. There is a commodity, Marx urges, the actual process of whose use is at the same time the process of the creation of value. Such a commodity is nothing more or less than human labour power. Its use is labour, and labour creates value. The owner of money buys labour power at its value, which is determined, like the value of every other commodity, by the 'socially necessary' labour time required for its production. In other words, the value of labour power is the cost of the maintenance of the labourer and his family. When the owner of money buys that labour power, he is then entitled to use it by setting it to work for the whole day, i.e., over and above the 'necessary' labour time. It then follows that, in the course of the 'necessary' labour time, the labourer produces sufficient to pay back the cost of maintaining himself and his family; but in the course of 'surplus' labour time, he produces in addition a 'surplus' product or a 'surplus' value for which the capitalist does not pay him. It is thus in capital that there should be distinguished two parts in so far as the process of

profit, interest, and ground-rent.

production is concerned: constant capital and variable capital. Constant capital is that part which is expended for the means of production, e.g., machinery, tools, raw materials and the like, and the value of that part is all at once or piece-meal transferred, unchanged, to the finished product; whereas variable capital is expended for labour power, and the value of that part is not constant, but grows in the labour process and hence creates surplus value. In the assessment of the degree of exploitation of labour power by capital, Marx compares the surplus value, not with the whole capital but only with the variable part of it.

Having pointed out the origin of surplus value, Marx adds that there are two historical pre-requisites to the genesis of capital. There should be an accumulation of a considerable sum of money in the hands of individuals living under conditions in which there is a comparatively high development of commodity production. There should also be the existence of workers who are 'free' in a double sense of the term: from any constraint or restriction in respect of the sale of their labour power, and free from any bondage to the soil or to the means of production in general, i.e., of propertyless workers who cannot maintain their existence except by the sale of their labour power.

In the third volume of capital, Marx proceeds to show the reason why that average rate of profit has a tendency to fall. The starting-point in his analysis is the division of surplus value into profit, interest and ground-rent. Profit is the ratio between the

surplus value and all the capital invested in an undertaking. Capital with a "high organic composition", i.e., with a preponderance of constant capital over variable capital to an extent above the social average, yields a below-average rate of profit. Capital with a "low organic composition" yields an above-average rate of profit. Competition among the capitalists, who are free to transfer their capital from one branch of production to another, reduces the rate of profit in both cases to the average. The sum total of the values of all commodities in a given society coincides with the sum total of the prices of all the commodities. But in separate enterprises, and in separate branches of production, as a result of competition, commodities are sold, not in accordance with their values, but in accordance with the 'prices of production', which are equal to the expended capital, plus the average profit.

Marx then proceeds to investigate the three fundamental historical stages of the process whereby capitalism has increased the productivity of labour: simple co-operation, division of labour and manufacture, machinery and large-scale industry. An increase in the productivity of labour means a more rapid growth of constant capital in comparison with variable capital. In so far as surplus value is a function of variable capital alone, it is then manifest that the rate of profit - that is, the ratio of surplus value to the whole capital, and not its variable part alone

has a tendency to fall. Symbolically if

C stands for Constant Capital; and

V " " Variable Capital; and

S " " Surplus Value;

then, according to Marxian analysis,

$\frac{S}{V}$ = the degree of exploitation of labour; and

$\frac{S}{C+V}$ = the average rate of profit
(C+V being the whole capital expended)

Now, if it is assumed that all the time constant capital is accumulating and thereby accelerating the replacement of workers by machinery, and that the degree of exploitation $\frac{S}{V}$ is constant all the time on the grounds that when V decreases, S which is a function of V will correspondingly decrease, then it is obvious that $\frac{S}{C+V}$ will fall off accordingly. In other words, the average rate of profit will, in the long run, have a tendency to decline so long as capital accumulation is taking place over time. But it must be noted here that Marx is dogmatic about the constancy of the degree of exploitation $\frac{S}{V}$. True, it is a logical deduction that when V decreases, S which is assumed to be a function of V must also decrease in the meantime. But there seems to be no reason why both S and V should decrease to the same extent. Unless this dogma were removed, the Marxian concept of falling rate of profit would seem to be utterly unfounded.

2. THE ACCUMULATION OF CAPITAL. of the means of

By capital accumulation Marx means the transformation of a portion of surplus value into capital, and the application of this portion to additional production, instead of using it to supply the personal needs or to gratify the whims of capitalists. This portion of surplus value is in fact divided into 'means of production' plus variable capital. In the Marxian scheme, the more rapid growth of constant capital as compared with variable capital is immensely important in the process of development of capitalism as well as in the transformation of capitalism into socialism.

From accumulation of capital upon a capitalist foundation, Marx distinguishes the so-called 'primitive accumulation': the forcible severance of the labourer from the means of production, the driving of the peasants off the land, the stealing of the communal lands, the system of colonies and national debts, of protective tariffs and the like. 'Primitive accumulation', he states, creates, at one pole, the 'free' proletariat; at the other, the owner of money, the capitalist.

In his second volume of Capital, Marx attempts to analyse the reproduction of social capital, taken as a whole. Here, too, he deals, not with an individual phenomenon, but with a mass phenomenon; not with a fractional part of the economy, but with the economy as a whole. In this part of his work, Marx divides the whole of

social production into two major parts: production of the means of production, and production of articles for final consumption.

Further, he makes a detailed examination of the circulation of all social capital taken as a whole both when it is reproduced in its previous proportions and when accumulation takes place.

The upshot of Marxian analysis is that society will eventually be divided into two main classes: capitalists and proletariat as a result of the constant growth of monopolies and the centralisation of capital. Moreover, Marx brings the financial aspects of the matter into the fore and contends that financial empires are not to be necessarily based on technical economies. The effect of this tendency towards financial empires is that petty capitalists are finally destroyed and driven out into the army of the proletariat. In this way, the number of the capitalists becomes smaller and smaller, whereas the number of the proletariat bigger and bigger. This increased division of society into capitalists and proletariat is considered by Marx to be the principal cause of the breakdown of the capitalist system. He stresses that, in a social structure of such a type, crises will be growing always worse; and the recurrent shocks to the economy through the periodical occurrence of more and more acute crises will bring forth the downfall of capitalism as a historic development of society. Evidently the picture is in no way clear without an explanation of the root causes of crises in the Marxian sense.

3. THE PERIODICAL OCCURRENCE OF ACUTE CRISES.

In the Marxian scheme, the real cause of these crises has always been the accumulation of capital. When a level of full employment obtains, demand for labour will be buoyant and real wages of labour will be rising. This rise in real wages will leave over to the capitalists a lesser amount of surplus value, a fact which implies that the average rate of profit should tend to fall off so much that the capitalists will be inclined to refrain from embarking upon further accumulation. Thus surplus value ceases to be transformed into 'means of production' plus variable capital as a result of the decline in the average rate of profit; hence labourers will be thrown out of work. This state of involuntary unemployment will bring real wages down to the subsistence level as a result of the fierce competition for employment among labourers. A crisis therefore sets in, bringing in its train a state of unemployment, overproduction and misery among the working classes. But the diminution in real wages will entail a rising average rate of profit, and this rise will act as an economic force, on the part of the capitalists, towards resuming capital accumulation. In this way, the process is repeated over and over again, and crises occur periodically in capitalist societies.

It is interesting to note that Marx is the first economist who conceives of the economic system as being bound to move in that sort

of cycle with almost regular periodicity, and not in an ad hoc way. Marx, too, recognises that wages are to be kept at the subsistence level, but not on a Malthusian basis, i.e., not in terms of population movements. He denounces the treatment of men as being beasts or a high specie of the animal kingdom with natural sexuality. Malthusian theory of population might be a long-run theory. But Marx, in his nine-year cycle needed some theory to explain the reason why wages are kept at the subsistence level in the shorter run; he found this explanation in his doctrine of crises of overproduction. Wages are thus to be kept down to the level of subsistence as a result of the constantly increasing use of machinery, which gives rise to an ever-expanding level of unemployment and an ever-increasing army of labour.

4. INCREASING MISERY OF PROLETARIAT.

In the Marxian scheme, misery is connected with exploitation of labour in agricultural and non-agricultural industries alike, and increasing misery is connected with the increasing use of machinery as a result of technological advancement.

In this respect, Marx places special emphasis on the evolution of capitalism in agriculture by reference to the history of the ground-rent. His analysis shows how rent paid in labour services is transformed into rent paid in produce or in kind; then into

monetary rent, and finally into capitalist rent, when the place of the peasant has been taken by the agricultural entrepreneur, cultivating the soil with the help of wage labour. This is indeed of special importance in its bearing on backward countries.

The expropriation of part of the country folk, and the hunting of them off the land, does not merely 'set free' the workers for the uses of industrial capital, together with their means of subsistence and the materials of their labour; in addition it creates the home market. (Capital, Vol. I).

The impoverishment and the ruin of the agricultural population lead, in their turn, to the formation of a reserve army of labour for capital. In every capitalist country, part of the rural population is continually on the move, in course of transference to join the urban proletariat, the manufacturing proletariat. This source of a relative surplus population is, therefore, continually flowing. The agricultural labourer, therefore, has his wages kept down to the minimum, and always has one foot in the swamp of pauperism. (Capital, Vol. I).

The peasant's private ownership of the land he tills constitutes the basis of small-scale production and causes the latter to flourish and attain its classical form. But such petty production is only compatible with a narrow and primitive type of production, with a narrow and primitive framework of society. Under capitalism, the exploitation of the peasant "differs from the

exploitation of the industrial proletariat only in point of form. The exploiter is the same: Capital. The individual capitalists exploit the individual peasants through mortgages and usury, and the capitalist class exploits the peasant class through state taxation". Peasant agriculture, the smallholding system, is merely an expedient whereby the capitalist is enabled to extract profit, interest and rent from the land, while leaving the peasant proprietor to pay himself his own wages as best he may. As a rule, the peasant hands over to the capitalist society, i.e., the capitalist class, part of the wages of his own labour, sinking "down to the level of the Irish tenant - all this on the pretext of being the owner of private property". Peasant proprietorship, the smallholding system, which is the normal form of petty production, degenerates, withers, and perishes under capitalism. In agriculture as in industry, therefore, capitalism improves the productive process only at the price of the martyrdom of the producers".

The dispersion of the rural workers over large areas, states Marx, breaks down their powers of resistance at the very time when concentration is increasing the powers of the urban operatives in this respect. In modern agriculture, as in urban industry, the increased productivity and the greater mobility of labour are purchased at the cost of devastating labour power and making it a prey to disease. Moreover, every advance in capitalist agriculture

is an advance in the art, not only of robbing the worker, but also of robbing the soil. Capitalist production, therefore, is only able to develop the technique and the combination of the social process of production by simultaneously undermining the foundations of all wealth - the land and the workers. (Capital, Vol. I).

But Marx paints a one-sided picture of a capitalist society. He might be impressed by the conditions of his day when capitalism as a social organisation had not as yet taken a definite shape. If, on one side of the labour market under capitalism, the owners of capital have exercised monopolistic powers and made collusive arrangements with the result that agricultural and urban labour power have immensely been exploited and impoverished, it is equally true that, at later stages of the evolution of capitalism, and on the other side of the labour market, the owners of labour power have exercised the same monopolistic tendencies and collective bargaining strength through trade unionism to the exclusion of the idea of exploitation in whole or at least in part. As historical evidence bears out, labour movements in this direction have made it clear that the interests of the labourers and their employers, the monopolistic capitalists, sometimes coincide; that, with monopoly, the monopolist is perhaps the friend, and not the foe, of the labourer.

Turning to the fundamental issue, that the increasing misery of proletariat is the offspring of the increasing use of machinery

and large-scale industry, here as elsewhere Marx slips into a gross error. He contends that as wages go up, when trade is thriving, employers usually look for economies in production costs by substituting machinery for labour in the performance of particular jobs. In other words, higher wages would be an impetus for the employers to encourage inventive ability and progress in technology, to rely more and more on inanimate powers of production over which they have complete control rather than on the labour powers of production, over which their control is comparatively small. This is what is sometimes technically called the economy of high wages, i.e., dearer labour combined with elaborate machinery to bring about the diminution in production costs. The substitution of machinery for labour, or what Marx calls the increasing mechanisation of industry, will carry with it the reduction of wages to the lowest level, the overabundance of labour along with an ever-decreasing demand for it, and hence an ever-increasing level of unemployment with all the symptoms of proletariat misery and destitution. It is thus readily seen that Marx builds up this logical sequence of events on the fundamental assumption that machinery is all the time a perfect substitute for labour, that labour can be dispensed with indefinitely. But herein lies a logical error in his scheme. In its modern and refined form, the theory of production presupposes that the substitutability of the factors of production, is merely to be effective at the margin.

But even at the margin, it can hardly be admitted that labour can be dispensed with altogether. The newly constructed machinery which is to replace labour power at the margin of production is virtually the embodiment of the dearer labour meanwhile. Marx appears to slip into the same error, as did Ricardo before him, when the latter discussed the transformation of circulating capital into fixed capital and its adverse effect on the level of employment on the grounds that fixed capital employs less labour than circulating capital.⁽¹⁾ It has been pointed out already, in this connection, that the real effect is not less employment, but less additional employment, that one should consider not only the use of fixed capital, but also its construction and the amount of labour required for both purposes.

5. BREAKDOWN OF CAPITALISM.

The final issue of Marxian well-known sequence of events is the breakdown of capitalism. According to Marx, two things could bring this about: the self-generated and automatic collapse of the system; or the political struggle of the proletariat in the way of overthrowing the system. All that this means is a 'wait-and-take-over' policy; otherwise 'work-for-the-overthrow'. This has evidently an important political implication. Marx in fact

(1) C.f. Part I, Chapter 3, p. 108.

mentions both ideas; but neither of them with much elaboration.

When Marx talks of the collapse of the system as a result of the periodical occurrence of more and more acute crises, he means, but in a narrower sense, that economic progress comes to an end on account of the social structure itself. Social structures are usually associated with the state of technology; the latter only flourishes in those social structures which are appropriate to it. The history of mankind and of man's social activities abounds with many striking examples.

Three thousand years before the Christian era, Egypt was progressing in technology, and along the Nile Valley there were all the signs of advancement and of a great civilisation: the invention of agricultural methods, the irrigation system, building and the like. But this progress came to an end, as the society was 'static', i.e., not responsive to changes in technology which needed a corresponding change in the social structure. But why did the ancient Egyptian society fail to adapt itself to changing conditions of production? Lilley tries to answer this question by reference to the 'copper' age as distinct from the 'iron' age.⁽¹⁾ Sometime between 4000 and 3000 B.C., copper was discovered in the valley; but 1000 years earlier, iron had also been discovered. Iron had been a 'democratic' material, so to speak, for it had been

(1) Samuel Lilley, 'Men, Machines And History', A Short History of Tools And Machines In Relation To Social Progress, London, 1948.

plentiful and within the reach of the masses. But whereas the iron age had been a democratic one, this was not true of copper; for this metal at the time was relatively scarce and it was only in the possession of the very few wealthy people. In this way, the discovery of copper actually revolutionised the ancient Egyptian society, and thus there emerged a new social structure in which a few people came to dominate all the rest. In 3000 B.C., therefore, when this happened all further progress came to an end, simply because the interests of the leaders of the society, who were put at the top of the social ladder by virtue of their pecuniary position, were not in favour of further economic progress. So long as the technology embodied in copper prevailed, their economic and political privileges remained invulnerable. Another instance from the records of ancient Egyptian history is the story of the wheeled-carts. These wheels were said to have been known in the neighbouring territories one thousand years before they were practically introduced into Egypt. This introduction was delayed ten centuries simply because the masters of the Valley were not interested in wheels; in fact they built the pyramids without wheels.

In the same way, the decline of Rome and Greece was associated with the growth of the slave economy. This new method of production, new technology, put an end to technical progress in 100 B.C., again for the same reason. If the society were thriving

under a slave economy, and the masters of Rome and Greece were enriched by it and interested in its continuation, there would be no place for technical progress under such circumstances, as there was no driving force to stimulate technology neither by the Masters nor, of course, by their slaves. *They could be improved. But*

The examples given will make it clear that this stagnation of technique was not caused by a lack of problems to be solved, or lack of obvious deficiencies to be rectified. Some of the problems might have been too difficult at that particular stage of progress, but simple improvements were by no means beyond the capabilities of men's minds at that time. Some deeper explanation must be sought. The most probable explanation lies in the nature of the social system which dominated the advanced part of the world in this period of stagnation. The appearance of class-divided society was necessary for the development of man's technical equipment beyond a certain stage. But this social structure did not ensure uninterrupted progress; at times it retarded technical progress for long periods. How did this come about?

When the great social changes were complete and the class-divisions fixed and hardened, the societies of this period were divided, broadly speaking, into two classes. The great mass of the people, belonging to the oppressed classes of peasants, slaves and serfs, did all the productive work of the community, but received in return only the bare necessities of life. The small

ruling class of priests, nobles and kings did no productive work, but lived luxuriously on the products of the work of others. The labouring classes were familiar with the techniques already in existence, and they had the practical experience from which it would have been possible to learn how they could be improved. But they had no incentive to make improvements, since any resulting increase of production would be taken from them and used merely to increase the well-being of their masters. Nor, worked to the utmost night and day, did they have the leisure required for invention. The ruling class, on the other hand, saw the world only from the point of view of consumers. Ignorant of the actual methods of production, they could not usually be aware of technical deficiencies, nor had they practical knowledge to effect improvements. They were familiar with the art of exploitation of government, of extracting the last available grain of corn from the peasant, and in these arts they produced many improvements. But they were incapable of advancing the technical methods of society. Thus, with one class possessing the requisite knowledge and experience, but lacking incentive and leisure, and the other class lacking the knowledge and experience, there was no means by which technical progress could be achieved. (1)

If now that is the sense for which the social structure may be conceived by the Marxists, how does it fit in with capitalism when

(1) Ibid., pp. 17-18.

the system breaks down? Marx's answer lies in the proposition that crises will be getting worse and worse until these periodical shocks to the economy will ultimately burst it asunder and sound the knell of capitalism. But why will the crises be getting worse? In Marxian economics, there is no answer. Moreover, in Marxian analysis, the crisis is due to the fact that wages would push down profits in the shorter run; hence the capitalists would refrain from further accumulation of capital. In Marxian analysis, however, there will also be an ever-increasing use of machinery in the longer run. Now if we fuse together the shorter and the longer run propositions in the Marxian scheme of things, the contradiction will be readily seen. For if there will be an ever-increasing use of machinery and thereby an ever-increasing reserve army of labour, wages, by implication, will tend to be pushed down to the subsistence level all the time. As a corollary, there will be no danger of crises in the Marxian sense, i.e., higher wages pushing down profits in the shorter run. Marx does not really support his vision by sound economic analysis. Here and there one can easily find flaws in his arguments. Marx's followers were aware of the weakness of his theory of falling rate of profit in an attempt to explain the phenomenon of recurrent crises. In Marx, however, there were occasional hints at the concept of under-consumption, but he seemed reluctant to attach much importance to it. True Marxists therefore decided the under-consumption theory.

And, since Keynes has formulated his famous theory of chronic stagnation on the basis of 'oversaving' or 'under-consumption', Marxism and Keynesianism are sometimes believed to be following the same line of thought. What Keynes has written is sometimes believed to be true Marxism.

But if the capitalist system would not eventually collapse, then the duty of the communist party would be to work earnestly for its overthrow. In point of fact, most communists attach much more importance to the overthrow of the system than to its eventual collapse. When the proletariat become more and more disciplined, united and organised under intelligent leadership, they will no longer tolerate the division of society into two conflicting classes: capitalists and proletariat. The ultimate end will therefore be a revolution to be directed in such a way that the expropriators become expropriated. In other words, the ultimate end will be the socialisation of all means of production. This seems to be an odd line of argument, which is by no means in consonance with the history of sociological development. Even in Marxian theory of history, society is developed and advanced by virtue of the efforts of the creative minority, the enlightened leaders at the top, not by ill-conceived emotions and irresponsible action by the masses. In his interpretation of the history of human society, Marx indeed admits that capitalist society was created by the new capitalists, formerly the feudal lords, who had the strength, cleverness and initiative to make use of new technology and achieve a rapid

development of the economy. If a new society were created by the rebellious poor, it would inevitably be foredoomed to failure; such a society, none the less, would be incompatible with the Marxian views on the theory of human society. If ever these rebellious poor create a society, they will never create a beautiful Utopian society; instead they will merely create chaos. It then follows that the overthrow of the capitalist system can hardly be squared with other parts of Marxism.

Besides, it is not genuinely a rebellion of the proletariat themselves, but of the Communist Party, pure and simple, in the sense that the Party takes advantage of any opportunity to create rebellion or take over somebody else's rebellion. Peasants may rebel and then the Communist Party steps into the political arena and takes over; the same is true of other sections of the community. The Party can only take over power by virtue of other people's rebellions. But the Communist Party is not a class in itself, for it is not a class in the Marxian sense. It is thus hardly conceivable to get from Marxist analysis to Marxist vision of creating a classless society.

However, since the days of Marx and Engels, other groups of Socialists have emerged. They have not been 'revolutionary' in the Marxian sense, but 'evolutionary' in the sense of being more inclined to await developments. They have revealed a tendency towards the refutation of both the materialistic interpretation of

history and the theory of 'surplus value'; but they have accepted the doctrines of class struggle, internationalism, and the socialisation of the instruments of production by reliance upon universal suffrage and the processes of democracy. The Fabians, on the other hand, reject Marx and draw upon J.S. Mill and Henry George. They are essentially idealists, and stand for gradual reform. Their chief reliance has been upon education, and their most generally accepted aim has been the government appropriation of 'unearned income', both from land and from capital. Meanwhile, Syndicalism as a socialist movement came into being about 1875 in France. While the Syndicalists are extremely radical, they are non-Marxian; and their beliefs are more influenced by Proudhon's anarchism. They have a different idea of the part to be played by the State. While accepting the doctrine of class struggle, they aim at the abolition of the political state, and the substitution of a condition of self-government by the workers, who are to be organised in non-political 'industrial' unions.

The influence of Socialism upon economic thought has been very marked indeed. The so-called 'scientific' socialism has emphasised the idea that social institutions are of historical growth and relative to environment. Socialists have also given greater strength to such tendency as there has been among economists to take the social point of view, as they have persistently stressed that modern methods of production involve a great deal of co-operation, and that the product is to that extent a social product. Moreover, socialistic criticism has led

to a greater interest in the question of distributive justice and a closer analysis of the economic functions of the state. The discussion of this topic has rendered possible a more accurate separation of those activities which are most profitably entrusted to the State, from those which are, all things considered, carried on most efficiently by private enterprise. A saner individualism has been the ultimate outcome, while at the same time people have become no longer alarmed when the State takes over some branch of industry, which the principles of economics and politics show that it will be best administered for the public good when in public hands.

reasoning and a tendency towards a subjective study of the problems of production and distribution. The School attempted to explain economic and social phenomena as the result of individual behaviour. The market economy was considered as consisting of a large number of individual economies, each seeking to maximize its 'utility', and each finding itself in perfect competition with the others. This abstract conception of a perfect market consisting of a great number of competing consumers and competing entrepreneurs became the intellectual basis of the New School. It was a mistake to believe that the New School was far removed from reality. The economy of 1850-1870, which was an economy of small-scale enterprises and individualism.

CHAPTER 6.

THE CLASH BETWEEN SECURITY AND MATERIAL PROGRESS.

During the second half of the nineteenth century, there had been a systematic attempt to reinterpret the whole matter of value and distribution in terms of subjective utility, thus breaking away from the Classical School who based their value theory on cost, and particularly labour cost. The great names in this process of reinterpretation of economic science are Jevons, Menger, Walras, Bohm-Bawerk, Marshall, Wicksell and Wicksteed. The common denominator of the New School was a decided return to abstract reasoning and a tendency towards a subjective study of the problems of production and distribution. The School attempted to explain economic and social phenomena as the result of individual behaviour. The market economy was considered as consisting of a large number of individual economies, each seeking to maximise its 'utility', and each finding itself in perfect competition with the others. This abstract conception of a perfect market economy consisting of a great number of competing consumers and competing entrepreneurs became the intellectual model of the New School. It would be a mistake to believe that this ideal type of market economy was so far removed from reality than as it appears to-day. The economy of 1850-1870, when most of the ideas of the School were formulated, was an economy of small-scale producers and peasants with neither

cartels nor trade unions and with a minimum of interference in the form of tariffs or social legislation.

Of the neoclassical economists, Thünen (1783-1850) was the first to develop the concept of marginal productivity which has remained till to-day the predominant concept and technique of analysis in neoclassical distribution theory, of course, along with some constraints and serious qualifications. A. Marshall (1842-1924) came along to outline the central idea of his celebrated work, *Principles of Economics* (1890) in an *Essay on Mr. Mill's Value Theory* (1876), by stating that it is not utility alone, but utility and costs, that determine value, and that value is determined at the equilibrium point of supply and demand. It is in this way that Marshall was able to preserve a good deal of the classical value analysis for the purposes of the new subjective school. But a more decisive break with the classical doctrine of value came with the reinterpretation of costs as opportunity costs by such Austrian economists as Böhm-Bawerk and Wieser, and their contemporary Knut Wicksell. Wicksell's famous work, *Lectures on Political Economy*, fused the main teachings of Walras and the early Austrians with great ingenuity, giving to the philosophical insight of Menger and his followers the superior precision and elegance of the mathematical formulation. Wicksteed's contribution to economic science, *The Common Sense of Political Economy* (1910), has pointed out that, with Wicksteed as well as Wicksell, it is utility and

utility alone which serves as the central concept of a unified interpretation of the economic universe. Indeed the classical interpretation of the market economy in terms of the social facts of costs is replaced completely by an analysis in terms of the subjective concept of marginal utility.

Thus the Marginal School, and afterwards its derivative, the Mathematical School, both have largely shifted the emphasis from objectivism to subjectivism based upon particular postulates, from macro-economics to micro-economics, from the explanation of the behaviour of the national economy as one integral whole to that of the individual economic units within the economy.

Such is the scheme of economics which the Marginal School has impressed upon the minds of the students of economic science.

Even some of the ablest economists, until quite recently, have been impressed by the magic of the marginal calculus, indulged almost exclusively in abstract reasoning, and confined the scope of their study to mere explanation of economic behaviour from the individual, rather than from the national, point of view. The more recent elaborations and complications of the marginal concept, which some of the modern theorists have attempted to formulate, might then be reduced to a mere intellectual exercise. This is perhaps most interesting to the academic student, but it leads nowhere in solving the economic problems of the real world. If the work of the theorists is nothing more or less than a logical exercise, which

has in fact little bearing upon reality, then what is the use of economic theory in such an absolutely abstract form?

Fortunately, greater minds have never lost sight of a scheme of economic dynamics, and the tendency has recently been towards the analysis of the national income, its elements of growth, and a long run theory of development. With this new trend in economic thinking are associated the names of Harrod, Samuelson, Clark, Schumpeter, Fisher, Hilton, Keynes and Hansen. It is therefore the task of this and the following chapters to survey briefly some of the more recent trends in the theory of economic development, at least to find out what continuity of economic thought there may exist between Old and New Economics, i.e., before and after the establishment of the marginal utility school.

1. ECONOMIC PROGRESS AND SOCIAL SECURITY.

Professor Fisher's work, 'Economic Progress And Social Security', contains some material which is necessary to the theory of economic development, although it is primarily concerned with the adaptation of economic life to changing conditions rather than with the explanation of these changes.⁽¹⁾

Fisher starts his analysis of the economic problem involved in material progress with the classification of economic activities into three types: primary including agriculture and mining,

(1) Allan G.B. Fisher, *Economic Progress And Social Security*, London, 1945.

secondary including manufacturing processes in all its forms, and tertiary including a wide range of economic activities which are primarily devoted to the production of services. In every progressive economy, there has been a steady shift of employment and investment from the essential 'primary' activities, to secondary activities of all kinds and, to a still greater extent, into tertiary production. And, shifts of employment towards secondary and tertiary production are the inescapable reflection of economic progress. If we do not have the one, we cannot have the other. Any attempt to prevent these shifts of employment is in the meantime an attempt to prevent improvements in the level of the average real income.

Fisher then proceeds to investigate the desirability of economic progress. He remarks that material progress seems to be distasteful to some people who contend that it is in no way consistent with the cultivation of higher social values. True material progress is no guarantee of cultural progress, but the latter will be seldom carried very far unless the community possesses adequate resources which material progress alone makes possible. More significant, however, is a variant form of the argument which maintains, not that economic progress is a base materialist notion, the pursuit of which leads people astray from the cultivation of higher cultural values, but rather that it is not something which the ordinary man really wants. It is

security that really interests and excites him. Some people even go so far as to argue that in case there should arise a clash between security and material progress, security must be maintained even if it involves the sacrifice or the postponement of progress. But before throwing ourselves on the side of those who ask for security, and nothing but security, care must be taken that the real meaning of the term is properly understood.

By security is really meant one of two alternatives: either getting back to one's old employment when one is embarrassed by a temporary loss of it in the economic framework; or, alternatively, taking up a different type of employment. These two alternatives in fact correspond to two divergent interpretations of security and two equally divergent security policies. It is therefore essential to distinguish between stability for the economy as a whole, with individuals from time to time changing their places in it, and stability of each individual in the economic structure in the sense of ensuring precisely the same place as he has occupied before. These two distinct interpretations of security carry with them two distinct policy approaches to the problem of insecurity. The former policy is consistent with the achievement of both material progress and security, whereas the latter policy, if universally adopted, would make progress quite unattainable and security in the end highly improbable.

The ordinary man usually thinks of economic security in terms

of obtaining a job, the kind of job he will be expected to do, and the rate at which it will be paid. Securing any kind of work is certainly not a matter of indifference. Work is important not only as a means of ensuring an income; it also affects the individual's sense of self-respect, and not every kind of work will satisfy this test. Work must be recognised as being useful. Digging holes and filling them up again will not do. Many people, moreover, have a quite natural prejudice in favour either of work to which they are already accustomed, or at least some kind of work which is not too widely different. Many disappointments which attended efforts at 'work creation' during the depression were the result of that prejudice.

It is indeed beyond dispute that material progress and widespread unemployment have sometimes been found side by side. How far is this association inevitable? How are we to get economic security without stagnation and decline? Is this problem insoluble? Fisher answers these questions by stating that, if we want security, our efforts for that purpose must, in the modern world, be frustrated unless at the same time we strive for progress. Similarly, though for different reasons, our efforts to achieve progress may be frustrated unless at the same time we provide at least a greater measure of security. The failure to satisfy the desire for security, which is now commonly felt, would encourage a stubborn resistance to changes without which progress can hardly be

achieved. This statement brings us back to the two conflicting interpretations of security or stability. On one interpretation, the individual is secure if he is left undisturbed or restored to the possession of his previous job. On another, stability is characteristic of a constantly developing economy, in which changes in individual employment are considered as being the normal course of economic development, though associated as far as possible with arrangements to ensure that customary incomes will not be unnecessarily disturbed. The second is the correct one, and policy should be based upon it rather than upon keeping one's customary job and maintaining one's income intact.

Fisher then goes to analyse the dynamics of a progressive economy. He recognises that, in the future as well as in the past, the great practical economic problem is the efficient organisation of appropriate transfers of productive resources. The immediate causes for structural readjustments are often varied and numerous, but in the last analysis they may be resolved into changes in productive techniques and changes in consumers' tastes. It is difficult, Fisher admits, to predict in detail the nature of the new goods and services which a community with a rising income-standards will wish to purchase, but observations of the expenditure habits of people who are already wealthy, aided by general reasoning, would enable us to make some safe generalisations about what is likely to occur when poor

communities find that they can spend more than they have been in the habit of spending in the past. From this emerges the thesis that progress implies a continual transfer of labour and other resources from 'primary' to 'secondary' industries and, in really prosperous countries, to 'tertiary' industries. So long as the objective conditions for material progress are present, there will always be a tendency for the relative importance of primary products to diminish, and the relative importance of tertiary industry to increase.

Fisher then proceeds to discuss the mechanism by which the reallocation of productive resources is effected in the market economy as a result of the adoption of a new productive technique or a change in consumers' tastes. Let us first assume an improvement in the productive technique and consider the primary effects of such a change upon the economy. Goods or services can be placed upon the market which give better value to their purchasers because either their price is lower or their quality higher. However, there are also secondary effects upon the economy as a whole; and they depend first upon the character of demand for the cheaper product, i.e., whether the demand for it is sufficiently elastic or is relatively inelastic.

When the demand for the cheaper product is sufficiently elastic, i.e., when consumers are induced by the diminution in price to increase their purchases on a sufficiently large scale, the change may not necessitate any ejection of labour from the industry affected.

This kind of change requires only some rearrangement of resources in the industry concerned, and there will be involved no problems of unemployment or insecurity arising directly from technical change. But the position is different if the impact of the change falls first upon those industries for whose products demand is relatively inelastic. In this case, the 'ejective' power upon labour then gets to work first, and there will arise the problem of generating a corresponding 'attractive' power in other fields of employment with the least possible delay. Consumers of goods with an inelastic demand will be very pleased when they observe that the price of these goods has fallen, and may even buy more of them. However, they are now able to purchase all they want of these things with a smaller expenditure of money, and they usually prefer to spend on other items part of the free money placed at their disposal so that they will not maintain at the old level the demand for labour in the industries affected by technical change. The producer may therefore discover that his services are no longer required in the old field. He must then find out some other field, which in principle should be in an industry in which the consumer, who has now some free money to spend, will demand some extra goods. In the field of agriculture, for instance, where the demand for essential foodstuffs is relatively inelastic, problems of displaced labour created by such technical improvements are of course very familiar.

Nevertheless, the essential character of the insecurity problem is bound to be involved in both cases. Even if all technical changes happen to be imposed upon industries for whose products the demand is sufficiently elastic, there is still the problem of displaced labour, and there are still some people who find that their services in the old field are no longer wanted as a result of changes for which they have no responsibility and over which they can exert but little control. But even though such people still present a problem, the prospects for fixing them up in a new place in the productive structure will be more promising, if the industries, upon which the first impact of the technical change has fallen, are rapidly expanding. It is therefore of practical importance whether the 'attractive' or 'ejective' power gets to work first.

If this were all that Fisher's work implies, though important in itself, it would hardly fall within the scope of study of the theory of economic development. His assumption that technical improvements will constantly be forthcoming is essentially based on extrapolation from observed past trends. His analysis so far is nothing more or less than exploring the implications of constant technical improvements in terms of the re-allocation of productive resources as between different lines of production; but such an analysis can only be reduced to an exercise in market theory. Nevertheless, Fisher's principal contribution to the theory of

economic development lies rather in his detailed study of the resistances which the transfer of resources encounters, and in his observations that, when these resistances are markedly effective, market adjustments are not completed and available technical improvements fail to be appropriated and utilised. Resistances may take many forms, but broadly they can be classified into passive resistances and active resistances.

Passive resistances usually take the form of a refusal to move to places of higher remuneration. This phenomenon is a common feature in the discussion of problems of 'factor mobility' and largely responsible for the high level of unemployment in the so-called 'Depressed Areas' in Great Britain during the inter-war period, so much that Sir William Beveridge and others advanced the proposition of moving capital to labour into those areas rather than moving labour from those areas into capital elsewhere. In fact, economists have found this concept of passive resistance essential to explain the persistent inequalities in remuneration or in employment opportunities. Resistance, however, may be active, through political activities and other channels outside the market. An analysis of the conditions which bring forth an active resistance of this type implies an analysis of the strength of the motive of security and the various institutional and other factors, which may determine the form which resistance takes. But it is worthy of note here that neither material progress is the only

menace to the security of particular groups, nor is security the only motive to economic operations outside the market.

Inventions in the Schumpeterian sense are treated as economically irrelevant until they are given practical application as a 'new combination' of resources. (1) It can thus be observed that Fisher's analysis reveals incidentally an important factor among those which determine when inventions will become economically relevant. For material progress, in Fisher's analysis, requires the transfer of labour and capital from such industries as the advance of technical knowledge has made more efficient into other, and in many instances, new industries. Resistances to transfer of resources not only cause over-production and depression in the former industries but also prevent the emergence of new ones.

Fisher cites, as an illustration of active resistances, the reactions to technical improvements which are often revealed by monopolistic elements. He believes, rightly or wrongly, that the distinction between goods with elastic and inelastic demand has some significance here, not so much because the prudent monopolist is always tending to keep this factor in mind when he determines his pricing policy, but because the effect of monopolistic tendencies must be in the direction of maintaining output at a lower level than would be attained under free competition.

(1) Joseph A. Schumpeter, *The Theory Of Economic Development*.

In some instances, an expansion of output may go so far as to entail the employment of a larger volume of resources than before in the industries affected by the change in productive techniques. But in this case the 'attractive' power of the impact of technical improvement will be significantly weakened by monopolistic influences. In some other instances, however, the output of the monopolistic industries affected by the change in productive techniques may reach such a high level that the 'attractive' power of the impact of technical progress will be strengthened, and not weakened, by monopolistic influences. Some recent reports on the supply of certain monopolistic industries have revealed that there have been no signs of restriction of capacity in post-war years; but on the contrary improved efficiency as a result of the exchange of technical information on the basis of a "system of regulated competition" has resulted in a steady and progressive fall in real costs of production and in an expansion of output.⁽¹⁾ It seems that the attitude of the managerial class has virtually changed. Immediate profits are now of less concern than continuity and stability. That is a natural consequence of the managerial revolution through which the business world is now passing.

(1) C.f. The Monopolies And Restrictive Practices Commission:
 Report on the Supply of Cast Iron Rainwater Goods, London 1951,
 Sec. 139, p. 39.
 Report on the Supply of Electric Lamps, London, 1951, Sec. 233, pp.83-84.
 Report on the Supply of Insulated Electric Wires and Cables, London, 1952,
 Chapter 16, p. 76 seq.

More specifically, Fisher conceives of five barriers to progress. (1) First come the moral and cultural standards as contrasted with the materialist standards, as well as the conservative attitude of preserving the cherished ways of life. Besides, material progress threatens loss to important groups, who accordingly take such measures as may be effective to protect themselves, thus reinforcing any other forces which may be generating instability and creating additional risks of insecurity both for others and often for themselves as well. Two groups are likely to exert such an obstructive influence. The first group comprise those who are already operating in fields the expansion of which would harmonise with the trend towards material progress; but the members of this group will naturally dislike inconvenient competition which may bring their incomes below the customary level. Thus they tend to obstruct the flow of competing capital into their industry and limit entry of new competitors by various devices. A striking example is the case of professional men in the field of tertiary production. The second group comprise those who may find the demand for their products falling off as technical change facilitates the cheap production of other things with a highly elastic demand. Expansion of this kind of demand inevitably means a decline in the demand for other products, directly or indirectly competitive with them; and the risk of loss may induce the

(1) Allan G.B. Fisher, *Economic Progress And Social Security*, London, 1945, Chapter VII, pp. 74-92.

capitalists concerned to attempt to check this inconvenient trend. But even if structural adjustments might be made without friction, the course of material progress must inevitably change the relative positions of groups of people occupying different places in the income scale. These changes may seem very inconvenient, and require some re-ordering of the customary mode of life of the wealthier class, e.g., the shortage of domestic service due to progress. Finally the extension of luxuries and amenities of life to the poorer members of the community will tend to increase the congestion at the middle of the social ladder where the great middle class is already congregated; in other words, the nearer will the rich and the poor approach this middle point. Perhaps the poor will still feel that they are at the bottom while those at the top will feel that they have been deprived of something which does not appear to have benefited anyone. The whole idea of progress may therefore be frustrated.

In the light of the above analysis, Fisher comes to the conclusion that, if these serious obstacles which stand in the way of material progress were not removed, and hence the necessary transfers of resources were not made, not only would the average level of income fail to rise as improvements in efficiency of production would warrant, but the failure to make such transfers would also mean the loss of the individual or group security which is usually the object of resistance to structural readjustments.

(1) *Are Trade Unions Destructive?* An Impartial Enquiry, London, 1911, edited by John Hilton, J.J. Mallon, Wm. Morris, G.D. Brown, Sir Arthur Salter and Frank D. Stuart.

2. ARE TRADE UNIONS OBSTRUCTIVE ?

The obstructiveness of trade unions is a topic which seems to be more or less related to Fisher's thesis that there may exist a clash between security and material progress. For trade unions, it is alleged, impose obsolete restrictions upon flexibility of industry in order to secure their position towards their employers in respect of the rates of pay and conditions of work.

In his discussion of barriers to progress, Fisher has seemed to focus his attention only upon the passive resistances on the part of workers and the active resistances on the part of employers, to the structural adjustments necessary for the assimilation of technical improvements. In other words, he has neglected the active resistances alleged to be made on the part of trade unions as representatives of different sections of labour. In a sense, therefore, the work edited by John Hilton and others may be considered as a complement to Fisher's. ⁽¹⁾

The purpose of this work is to find a satisfactory answer to the question embodied in its title by means of empirical observations and investigations with reference to some main groups of industries where trade union practices are deemed to be largely effective. Specifically, it is alleged that restrictive practices laid down by trade unions have been largely detrimental to the progress of the economy, and that trade unions have failed to

(1) Are Trade Unions Obstructive? An Impartial Enquiry, London, 1935, edited by John Hilton, J.J. Mallon, Sam Mavor, B.S. Rowntree, Sir Arthur Salter and Frank D. Stuart.

observe the changes which have radically affected the whole structure of industry throughout the world, or to recognise their responsibilities in the field of industrial relations of capital and labour. But the story is not as simple as that. On the other side, it is alleged with equal sincerity that barriers to progress, if any, come from the coercive and warlike practices of the employers themselves. They have failed to realise the aspirations, abilities and outlook of people who work for them and see the structure of industry from below. They have never learned to regard their employees' organisations as anything but weapons of offence directed against themselves. They have been as bad as the Trade Union leaders. They lack the vision either to recognise the portents of social and economic change or to admit workers to any share in the real control of industry. In respect of these as well as the previous charges, no body of information was available to support either of them. The work edited by Hilton and others provides this body of information. It is indeed an analysis of the main alleged obstructive practices on the part of trade unions, viz., wages policy, barriers to the introduction of new techniques based on elaborate and labour-saving machinery, arbitrary restrictions on apprenticeship, the restrictive policy of demarcation, and finally the 'go-slow' policy.

To begin with, trade union restrictions is a vague term, purporting to imply any stipulation a trade union may make in respect

of the terms and conditions on which its members will sell their labour. Employers have had widely divergent views as to what constitutes a trade union restriction. Some of them, however, have considered the refusal of unions to agree to a reduction of wages as the most grievous of all restrictions. But in answering the question of whether resistance to wage reductions has really to fall within the category of 'restrictions' or not, one has further to make the distinction between the general level of wages and particular cases of wages far above that level. As regards the general level of wages, the authors' position is to defend and advance the share of labour in the national product. In their view, this is the cardinal object of trade union movement. Otherwise, unions have to be damned from the start. True, the maintenance of over-high wages imposed by unions may be a principal cause of the persistence of trade depression and unemployment; if so, then trade union wages policy is the chief villain of the piece. But it is equally true that the levelling down of wages would intensify the trade depression; if so, then trade union wages policy is a laudable thing. The authors' discussion of this issue has led them to the conclusion that trade union policy of standing out for the highest general level of wages and working conditions that can be obtained without general hurt is not a trade union restriction.⁽¹⁾

(1) Ibid., p. 312.

(1) Ibid., p. 312.

As regards particular rates, which appear to be exceptionally high, they are justifiable by trade unions concerned on the grounds that the wages in question form so small a part of the total cost of the article that the employer and the public need not bother much about their abnormal level, that work, like other things, is worth what it can be made to fetch, and good organisation can make it fetch much more than it otherwise would. But wage-rates so far above the general level tend, on the one hand, to choke down the demand for whatever article it is that requires such labour, and, on the other, to bring many minds on the employers' side to bear on methods of production which would side-step the wage-profiteers. It is not easy, moreover, to point out that these exceptionally high rates are invariably enforced at the expense of other wages, but there is a general presumption that this is so, and in particular cases it is certainly so. On these two lines of argument, the authors conclude that the trade union movement would do well to look with disfavour on exceptionally high rates of pay.⁽¹⁾

But much more general in the evidence are the complaints of obstruction and extortion in the matter of overtime, night work and Sunday work. All employers, the authors say, take it for granted that extra payment is called for; but their grievance relates, not to the principle of extra payment, but to what they regard as exploitation and abuse. They refer to instances in which trade unionism tries to ban all working of overtime, or

(1) Ibid., p. 313.

insists on its being limited to few hours a week, or allows it to be worked only on payment of what the employers regard as exorbitant rates. As regards both the limits and the rates, they complain of the rigid adherence to the letter of the law and of little give-and-take on the part of unions. Besides, employers in the export sector of industry stress the disadvantages under which they suffer as against their foreign competitors who either pay no increased rate for overtime work or pay that rate but on a much lower scale. Trade unions' reply to these allegations is that overtime is an evil which must be avoided; and the employer who cannot so organise his work as to render it unnecessary must pay a deterrent penalty in the form of high overtime rates. Overtime is an evil because if it is systematic it cuts into a man's rightful leisure and subjects him to much strain, whereas if it is spasmodic it breaks without warning into the man's leisure and upsets his social arrangements and his home life. In either case, therefore, it is the worker's legitimate right to be so highly paid as to compensate him for these great inconveniences and strains. Moreover, overtime runs counter to the principle of spreading the available work among the greatest possible number of workers, especially in times of depression. On broad issue, the authors seem to side with the trade unions' point of view. The working week, as is laid down in collective agreements, is in their view quite long enough; and no employer is right in asking his

employees to work beyond the standard hours, except in cases of real emergency which could not have been foreseen in advance. (1)

The authors finally dwell on the obstruction imposed by trade unions on piece work, and refer to the complaints in some industries, e.g., building, wood-working, printing and docks, of the refusal of certain unions to allow their members to work under any form of payment by results. Employers in the industries concerned regard this practice as one of the most harmful of all restrictions, which accounts for a great deal of suffering and inefficiency in their branch of industry. Piece work versus day work is a controversial topic in business organisation already explored and well-documented. But it should only be noted here that there is no clear trade union doctrine on that subject, nor is there a uniformity in trade union attitude. For it has been observed that payment by results is the traditional and accepted system in such industries as coal, iron and steel, cotton, wool and several other industries. Still in some such industries as engineering and shipbuilding, some types of work are being done on the basis of piece rate while other types on day rate. Needless to say, the pros and cons of piece work versus day work vary not only from industry to industry, but from occupation to occupation, and even almost from job to job. The classical grounds for resisting piece work are well-known and scarcely need any further comment: deterioration of craftsmanship, inducement to

(1) Ibid., p. 316.

bad feelings and jealousy as between fellow-workers, destruction of the team spirit, scamping, encouragement of overwork to the point of exhaustion, inducement to subsequent rate-cutting, and finally the creation of friction and bad atmosphere all-round in the workshop. Everyone of these objections is found fully expressed in the evidence. The kind of work for which payment by results is resisted is almost always craft work. But much of the work, which was formerly done in a craft fashion, has, for many decades, been going over to mass-production; and, in mass repetition work, these considerations are no longer of account. In this transitional phase, the job goes to a different type and grade of worker. Craftsmen are thus thrown out of work, and no craft union is in a position to prevent such a change. (1)

As regards the obstruction imposed upon the introduction of machinery, the evidence collected by the authors discloses how much of the tension, which is being felt in industry, stems from the attempts made by craft unions to lay down what must happen to their members, when a job previously done by a craftsman with hand tools begins to be done on a machine or with the aid of mechanical appliances. The conflict covers three general questions: Who shall work the machines or appliances? How many men are required for their operations? What rates shall be paid to the operatives? In some instances, the union in question claims that the work shall be done on the machine by the class of men who did it by hand. The

(1) Ibid., pp. 318-319.

employer concerned sometimes agrees to such a stipulation. At other times he refuses to accept it on the plea that the new machine has dispensed with the need for the skill of the craftsman. What he really wants is an operative skill; he thus prefers to train his operative labour from the raw and proposes to pay no craft wage for an operative work. Trade unions, however, have an opposite view. They argue that the craftsman from whom work is being taken has a prior claim and a moral right to work the machine, that no one knows the feel of the material and the quality of the product so well as he does, and that it will pay the employer to make use of the craftsman at the craft rate rather than the operative at a lower rate. They also argue that, even if it costs the employer a little more, he is getting a much greater output from the machine and should not look forward to make a further profit by employing cheaper labour on it. In the authors' view, craft unions can put forward their own terms; their members can threaten to walk out if these terms are not accepted or they can stay in and make trouble right and left; but they cannot hope to win a lasting victory.

Machinery, the authors say, has for long time past been putting workers out of employment. Can one expect sweet reason from men who wait the next stroke of the axe? If with the new-appliances the work previously done can be done with one-third of the labour, then, even supposing the employer agrees to use skilled men on the

new process, two-thirds are going to lose their jobs. Their real aim is to deter him from bringing in the new plant. Who expects the skilled man to stand still while the machine that is to dispense with the need for his skill is to be installed? He has invested his life in the trade and everything he has is at stake. Text-book proofs that labour-saving machinery do not destroy employment mean nothing to him. He knows that mates have lost their jobs to machinery and he may lose his. Of course he will try to put a spoke in the new wheels. His terms are not those of a gangster, but of a die-hard; he will not see his skill cheapened without some effort to stop it. The semi-skilled man and the general labourer are in much the same boat. Indeed, aspects of the 'machine' question have caused as much bitterness in the cotton industry as in any other; and in cotton there is no strong craft tradition to overcome. In printing trade, on the other hand, it has proved possible to reach a high degree of mechanisation and at the same time to preserve and even to strengthen the skilled crafts. No doubt, the semi-skilled or unskilled man is in rather a stronger position in that he has less to lose and can more easily move over into any new employment that the labour-saving machinery can create. The craft unions are bearing the brunt of the attack at the moment, but workmen of all grades are threatened by the introduction of machines and appliances whose immediate result will be the discharging of staff. They know that they are between the devil

possible consideration for work

of losing their jobs and the deep sea of their employer losing his orders. Their best policy, as they see it, is to cheat the devil and risk the drowning. Is it the best policy? We doubt it. If the trade union movement as a whole thinks that, at a time like this, further improvement in technique and apparatus of production should be taboo, let it say so and persuade the nation to make it law. Or let it persuade the nation to the principle pronounced by a spokesman of the dock industry, that machinery which displaces labour should be taxed for the benefit of those whom it displaces. Or let it make a case for the patriarchal view, also put forward in the docks evidence, that an industry which has once included a man among its personnel should be therefore responsible for his maintenance, work or no work. These are rational and honest proposals which could command respect, if not ready support. But the policy of professing welcome to devices which will make production more efficient, and at the same time, obliquely doing everything to crab them, is doomed, it seems to us, not merely to fail, but to handicap organised labour in making the best for itself of the new conditions. The strategy is bad and the tactics are worse. Labour's better course is to co-operate wholeheartedly in increasing the efficiency of industry, wherever possible taking the lead; to nurse craft skill in its transition from one kind of craftsmanship to another; to use their weight with employers to ensure that all transitions are made with the maximum possible consideration for workers; to clear out of the way any

impediments to the meeting of new demands for industrial products wherever they may arise and in whatever form. (1)

Turning to the no less serious question of restrictions imposed by craft unions in the matter of apprenticeship, it may be reasoned that they should contrive restrictions in the supply of their members so that, by creating an artificial scarcity of the supply of the labour concerned, they are enabled to keep its price at a fancy level. In very few instances, however, has the evidence revealed clear cases of the price of a particular type of labour being raised by a deliberate limitation of its supply. The older method of keeping prices at a fancy level by restricting supplies is rapidly giving place to the provision of ample supplies at fixed prices. Trade union practice is in line with that of the rest of the community. In the professions, for instance, there exist resistances to the lowering of fees and salaries but no deliberate limitation of training for the professions. This does not mean that there are no restrictions on apprenticeship and other forms of entry, which lead to shortage in the supply of particular types of labour. There are some instances of restrictions and shortages, but they do not constitute important elements in any monopoly power the unions concerned may exercise.

One of the other complaints of employers is demarcation difficulties in the sense that each craft union defines the range of the work which 'belongs' to its members. When the boundary

(1) Ibid., pp. 322-23.

line of the province of each union is demarcated and no one who is not a member of the craft must do any of the jobs or operations within that boundary, this demarcation, it is alleged by employers, will not only cause friction, delay and loss while unions squabble among themselves, but it must occasion the use of successive workers belonging to different crafts for the performance of a small job, which anyone of them could do from the beginning up to the end. Fortunately, demarcation troubles are not so serious as they used to be; and some of the remaining restrictions are designed to ensure good and responsible workmanship through training and experience. This is the justification of the craft unions for the insistence on each job being done by the right man. But the argument seems to be strong in the case where a high quality of work is all-important; but it could scarcely apply where a work of a less vital nature, as, for instance repair work, is being done. In this case, friction, delays and avoidable costs are usually involved; and here there should be some ruling for the relaxation of craft rigidities on any such work.

Evidence also refers to some extracts from actual trade union rules under which fines are imposed for finishing a piece of work too soon, but it is uncertain how far these rules are genuinely effective. The unions concerned return these charges with counter-charges, that deficient outputs are largely due to faults and failures for which the management alone is responsible. "Slack

masters", say the authors, "make slack men, and it needs no trade union villainy to account for men putting very little into their part of the joint business of production when the employer sets the example. An employer should know just what is a fair day's work from each and every man; if he does not, he can neither praise, blame nor judge aright. His intelligence section is at fault and he had better get it mended But that does not exonerate the trade union that gives the wink and the nod to slacking." (1) No union, the authors go on, can afford to play about with ca'canny. Those employers do best, who recognise the great part the workpeople can play in making a good organisation work at a good speed and to a good purpose. Several of the trade union spokesmen express the wish that employers would more generally seek the collaboration of their workers in matters of workshop control and organisation.

To conclude, it might be asked what, on the evidence, trade union restrictions as a whole amount to in the industrial order. The general summing-up of the results of the enquiry reveals the fact that the obstructions to industrial efficiency and improvements set up by trade unions are not so serious as is commonly alleged or taken for granted. Moreover, it is clear, as the evidence bears out, that restrictive practices imposed by trade unions are in fact fewer than they were, and of less importance. In a number of industries, employers have referred to conditions

(1) Ibid., p. 332.

prevailing in the past, and have admitted that relatively their own grounds for complaint are small. Both trade unions and employers have learnt through experience, and there is a great deal more reasonableness than there used to be in the past decades.

It is well to bear in mind that the main factor holding back industrial efficiency are much more human than mechanical. Management and workers in their own and the general interest are equally concerned with that problem. There are few who do not realise that it can be solved, and maximum efficiency achieved, only if management and workers unite in a harmonious group, looking at the problem common to both from the same angle.

The elements of the problem jointly facing management and labour can be simply stated. Means must be found and applied to enable both men and machinery to be employed in the most economical manner and in such a way that the reward to all is both increased and assured. This is indeed a practical problem to which must be brought the qualities of good sense and good faith.

At the same time, it must be recognised that, in the past, this has often been dangerous ground on which to tread. The memories of trade-union leaders stretch back to old times and rooted in their minds is the fear that acceptance of new techniques may bring unemployment to their members. Scarcely less happy are the recollections of what sometimes resulted from wage systems which related earning to effort. On such basis restrictive practices

have been established and defended. Management, on the other hand, have often been deterred from capital investment in new equipment by the fear that any resultant economies would be reduced or nullified by the conditions the trade unions would attach to its use. Memories of the past and realities of the present place difficult obstacles in the path to progress. The vital question for all concerned is whether they can be overcome and whether there is the will to overcome them. The abandonment of restrictive practices is a hard doctrine for trade-union leaders, which they cannot be expected to adopt without far-reaching measures against the results they fear. Management, on their side, have the duty to establish the conditions of confidence without which progress is impossible.

If these problems have defied solution in the past, it is natural to ask whether there are any special reasons why they can be successfully overcome to-day. There are many. The first is to be found in the position of the trade unions themselves. Labour has now reached a new high status in the country's economy. That new status carries with it not only greater power but greater responsibility. So far, the unions have not fully awakened to their new position, but many are ready to move forward from their negative and defensive position to make the positive contribution they alone can do.

Conditions are favourable in another respect. Unemployment, in the sense in which it was known in the past, has been put behind,

perhaps for many years to come. The removal of this fear, which has haunted industrial relations in the past, provides the opportunity for management and labour to recognise frankly that their interests are common interests and can best be served by co-operation and not by conflict. At the same time, the attitude of management towards labour has significantly changed. In his search for efficiency, the manager of to-day regards not only the skill but the contentment of all for whose employment he is responsible as essential if technical efficiency is to reach its highest level.

These changes are real, and just as real is the change of atmosphere. To-day there appears to be a powerful desire that a new approach in a new spirit shall be made to these human problems of industry. But a new spirit in industry, by itself, is not enough: it must be translated into action over the whole field of industry. How, then, is the matter to be brought to the point of action? It is that if leaders of industry, both in management and in the unions, were publicly to declare their willingness to attempt a new approach, action could swiftly follow.

For the past ten years the Trades Union Congress and the Government have been urging the need for increased production, and to some extent this appeal has met with reasonable success. In spite of shortages of materials, the increase of production has been maintained, but many leaders of industry believe that it can be

In Industry, London, 1952.

Allan Flanders, Trade Unions, 1952, Chapter 72.

New Fabian Essays, edited by R.H. S. Crossman, London.

In A Full Employment Economy, 1944.

greatly extended if both sides of industry are prepared to eliminate existing restrictive practices.

The reports of the production teams which have crossed the Atlantic from Britain to study productivity in America all prove beyond any doubt that modern methods of production and scientific management, with the almost universal acceptance of incentive payment schemes, have made possible constant increases in real wages and have extended, rather than limited, the influence and scope of the American trade unions. Arising out of the report of the team of British trade union officials who visited the United States in 1949 to investigate the operations of the American trade unions as they affect industrial production, the General Council of the Trades Union Congress recommended that unions should: (a) interest themselves actively in modern production and management techniques to improve industrial efficiency; (b) employ staffs qualified to advise and assist on production problems, and establish where appropriate their own production departments; (c) provide for their members generous education and training facilities.

This represents a revolution in trade union thinking. But while the British trade unions have no desire to apply American methods of production in their entirety to British industries, the trade union movement is insisting on the need for increased production by means of modernisation and re-equipment. (1)

(1) C.f. Ministry Of Labour And National Service Centenary Lectures, The Worker in Industry, London, 1952.
 Allan Flanders, Trade Unions, 1952, Chapter VI;
 New Fabian Essays, edited by R.H.S. Crossman, London, 1952, Trade Unions In A Full Employment Economy, pp. 143-160.

Here, then, is a simple, positive and constructive approach which can be accepted and followed by all as one national team to produce the best results in industry. Once the purpose of industry is defined as the provision of the goods and services that the community requires with the minimum use of real resources, then the first part of this definition gives a practical and social meaning to industrial activity of every kind; the second implies the objective of high and increasing efficiency based on an ever-growing stream of technical and administrative knowledge.

In building an effective philosophy based on the above definition, the question arises, what are the essential parts of the industrial organisation? The answer is that there are three sides of industry, each having a definite function and interest in its working and results. These are: (1) the labourers of all grades who work in industry; (2) the management, which has the responsibility for organising the whole activity; (3) the Government which assumes the dual responsibility of taking over the managerial function in nationalised industries and of serving the interests of the consumers of the goods and services provided by industry as a whole. Each and every side of industry must play its effective part if successful results are to be achieved.

This new approach to the industrial problem, based as it is on the co-operation between labour, management, and Government, shows a way to the future development of under-developed countries.

To-day the first indications of a trade union movement in those countries are largely insignificant and the associations of labour are often formed on religious and recreational rather than occupational grounds, but growing industrialisation will naturally be associated with a parallel growth of trade union movements. However, the first need is for the leaders of industry, both in management and in the unions, as well as for the governments concerned, to declare their willingness to attempt a new approach in a new spirit to those human problems of industry, and to state in explicit terms what is the true aim and purpose of a trade union movement. Its aim and purpose must be in all circumstances to safeguard and improve the working and living standards of its members; but it cannot be pursued in isolation from the general and permanent interests of the community.

In such countries, the urgent need for the transmission and appropriation of up-to-date and efficient production methods and techniques in the whole field of industry is well recognised. What is not well recognised, or perhaps entirely overlooked, is the fact that the human and psychological factors in industry are no less important than the technical aspects. For both, the main responsibility must rest on management, which has not only to ensure the use of the best techniques of applied science, but must also provide the leadership vital to any healthy organisation. Management must see to it that the workers are satisfied, not only

with the remuneration they receive, but with their general life, treatment and opportunities for development, if they are to find the happiness in their work that is necessary to enable them to live a full and useful life. But any differences can be reconciled

by In under-developed countries, too many still think that the introduction of new methods and techniques is something from which the managerial class has the sole rights to benefit. In other words, labour will in no way share in reaping the fruits of increased productivity, for management will secure to itself the major part of any increase in the yields of industry. Thus the fundamental problem is how to stimulate the interest of the worker in increased productivity and in the prosperity of the firm which employs him in such a way that he can see and appreciate the personal advantage to him. Incentive payments, while in themselves essential to higher productivity, are not enough to develop in his mind the idea of the close association of interest between his job and management. Indeed, it is in the wider recognition of that community of interest that the kernel of the matter lies. Class struggle is out of date, and believers in it on both sides should recognise this. In under-developed countries, the wider recognition of the community of interest is, indeed, a vital factor in industrial relations which the trade unions alone can supply by modifying the climate of thought of the rank-and-file workers. With the growing power and strength that the unions

may possess, and the influence they may yield in national life, surely there will be a general acceptance of the idea that industry is a joint enterprise dependent on the efforts of both management and labour, and that any differences can be reconciled by discussion and negotiation against the background of common interest.

The future development of under-developed countries will be at stake if management and labour take up positions of permanent hostility in an atmosphere in which every difference of opinion becomes a battle to be fought rather than a problem to be solved. In those countries, management and labour should in no way be obsessed by the long-standing practices, old-fashioned traditions, or outworn doctrines which have haunted industrial relations in the nineteenth-century development of Western economies. In under-developed countries, these conditions did not exist in their past history and should not exist in their future development. If technical and industrial resources have to be used to the full, a new approach as defined above must be required on the part of employers and unions, an approach in which high productivity occupies a central place in their habit of thought and behaviour. This is a basic but simple philosophy for industry which all can accept as being logical, social and progressive in its implications. In its acceptance, there would be a firm foundation for united action in industry and for the release of the individual and

collective efforts which the economic situation in any under-developed country genuinely demands.

Granted that there must be a new approach in a new spirit, why is co-operation lacking? What is hindering this new spirit from finding expression at the actual point of industrial production in so many under-developed countries? It is what happens there that really matters. Active co-operation is indeed very rare. It is not that the workshop relations are bad. They are not. In many concerns they are peaceful and friendly. But active co-operation is something much more than a mere absence of strife. It involves a conscious concern for the increase of productivity and for the prosperity of the undertaking; but such concern is rarely forthcoming.

So once again what is it that is preventing that new spirit from getting through? What are the rocks that are impeding the channel. First and foremost is the fact that in many under-developed countries the government has assumed a peculiar attitude towards labour by seeking to suppress, on false pretences, the growth of free and independent trade unions. So long as this attitude governs state action in the sphere of industrial relations, so long will the way be barred to the modification of the climate of thought of the rank-and-file workers, which trade unions alone can achieve.

There is one real answer to any shortcomings on the government side. It is that, in many instances, the ruling class

in the Eastern community has its interests vested, directly or indirectly, in industry; and more often than not the ruling class and the managerial class are more or less identical. In other words, there are practically two, and not three, sides of industry in the under-developed economy. Thus the attitude of the ruling class has always been conditioned by these vested interests. Rooted in its consciousness is the fear that the unrestricted growth of labour movements may bring disastrous consequences which would threaten its very existence in the social frame. The rulers of many under-developed societies seem to be obsessed by the idea that labourers are the proletariat in the Marxian sense, and that, if they were free to organise themselves in strong and unified labour associations and take an active part in the social development of the society, they would sooner or later throw themselves on the side of communism, again in the Marxian sense.

This is one explanation of the peculiar attitude of the government on its political side. Another explanation on the economic side is that, if trade unions were freely and independently organised, then their chief purpose must be to improve the working and living standards of their members. This again would come into conflict with the interests of the capitalist, ruling class in two ways. First, the employers' attitude has always been conditioned by the desire to get cheap labour; but if strong and well-organised trade unions came into being and exercised a strong bargaining power in the labour market,

CHAPTER 7

SECULAR STAGNATION
IN THE NEW ECONOMICS

The foregoing discussion of the works of Fisher, Hilton and others contains some material which is necessary to the theory of economic development in the sense that it is concerned with the adaptation of economic life to changing conditions rather than with the explanation of these changes and their effect on economic life.

It is now time to discuss in one theoretical scheme certain changes of some conditions, viz., propensities of the people, population, geographical distribution of people and things and state of technology, and to investigate the effect of these changes on the level of economic activity in a well-developed economy.

Is there not a tendency, it might be asked, in a progressive economy for saving to outrun investment opportunities, with the inevitable result of more years of slump than of high employment, of long-lived depressions and brief recoveries? Such a view, pessimistic as it is, is often called 'secular stagnation', and is associated with the name of Professor Alvin H. Hansen.⁽¹⁾

According to him, dynamic investment is the mainspring of economic fluctuations. As investment shifts to high gear, the total demand is high and jobs are plentiful. When the capricious

(1) C.f. Alvin H. Hansen, *Fiscal Policy and Business Cycles*.

factors making for investment happen to be unfavourable for a long time, the economic system may go through decades of high unemployment. In respect of this proposition, almost all economists would agree with Hansen. But a number of them would not, when he goes on to state in his stagnation thesis that there are a number of long run factors in the American economy which lead to a situation whereby investment will be a lagging factor relative to saving. *Aspect of this theory*, says George Terborgh, "Hansen's reasoning is based on the concept of 'maturity' of the American economy. The frontier is gone, the rate of population growth is declining, and technology gives less room for revolutionary inventions comparable in impact to the railroad, electric power, or the automobile in earlier times. The weakening of these dynamic factors leaves the economy with a dearth of opportunities for private investment, which is increasingly confined to mere replacement of existing capital assets upon retirement. This replacement and such limited expansion as remains, can be financed largely from depreciation accruals and the retained earnings of business undertakings, hence absorb little or no personal savings. Meanwhile, these savings, unaffected by the dearth of investment opportunities, pile up as idle funds for which there is no outlet in new physical capital. This accumulation of savings gives rise to a downward spiral of income and production. The dearth of investment opportunities, which is the main feature of the 'mature' economy, precipitates

over-saving, and marks the beginning of a long period of secular stagnation and recurrent crises from which there will be no escape, except through government action. The government can only solve the problem either by expanding public investment or by taxing out of existence the excess savings which poison the economy. In a nutshell, the mature economy can survive only by reliance upon state action.

"One curious aspect of this theory", says George Terborgh, "is its development primarily in United States. Although it has drawn from the writings of Keynes most of its basic ideas on saving and investment, the peculiar doctrines of economic maturity have been elaborated in the United States under the leadership of Dr. A.H. Hansen. It is not too misleading to call it an American theory. If this theory were merely a matter of academic controversy, we should be content to leave it without exposition, confident that history would in time discredit it; but it has emerged into the arena of public propaganda and practical politics. It threatens through its impact on mass opinion and public policy to influence the history not only of ideas, but of social and economic institutions. A defeatist philosophy, if widely believed can so affect the economy that it helps to produce the very conditions it assumes. Ideas are social forces."⁽¹⁾

Hansen's stagnation thesis is principally based on four components. It starts with an interpretation of the general

(1) George Terborgh, *The Bogey of Economic Maturity*, published by the Machinery and Allied Products Institute, U.S.A.

relationship between saving and investment, as being the two economic magnitudes that determine the level of the national income. This interpretation serves as an analytical framework or premise for the whole discussion. Three conditions are then held to constitute economic maturity in the sense of bringing forth the dearth of investment opportunities, viz., the decline in population growth, passing of the frontier, and the dearth of great new capital-consuming industries. Two other elements in the theory are taken, by mistake, to be the cause of economic maturity, whereas, properly speaking, they should be considered as its effects, viz., the increasing relative importance of replacement in capital formation and of depreciation accruals as a source of financing capital.

(a) ON THE SAVING SIDE

The income stream flows daily to anyone who participates in the productive process, which includes the production of commodities and services of every kind and description. The size of this income stream depends upon the volume of purchases currently made; and these are of two major kinds: purchases of consumers' goods and services, and purchases of capital goods, e.g., industrial plant and machinery, public utility and railroad equipment, commercial and residential buildings. The volume of these two expenditure streams determines the size of the income stream. But the expenditure stream, which is mainly responsible for the rise and fall of the total income stream,

is that which is made on capital equipment and plant extension; when investment is made on a large scale, the total income is raised to a high level. In consequence, the income stream

A part of the total income stream, which is received or realised out of the processes of the previous period of production, will be spent on consumables and services, and will automatically become the source of a new income stream. But the part that is saved may or may not find its way back into the income stream, and this will depend upon whether or not these savings are used, either by the saver himself or by a borrower, for the purchase of capital goods.

If the saver does not himself use the funds, Hansen goes on, or if he fails to find a borrower who will use them to purchase capital goods, the income stream will dry up and unemployment will prevail in the capital goods industries. It is very essential that the part of the current flow of income which is not spent on consumables, i.e., that part which is saved, will be spent either directly by the saver himself or indirectly through a borrower on new plant and equipment of some kind or another. If the amount which is saved is large, as is usually the case at a high income level, it is necessary that equally large investment outlets be available for these savings. In every boom period, the flow of savings is spent on capital goods, and frequently these funds are increased by additional sums created out of an expansion of bank credit. In a depression

establish a presumption towards

expenditures on capital goods deteriorate; savers are reluctant themselves to purchase such goods with their savings, or unable to find borrowers to do so. In consequence, the income stream dries up. Besides, the stream of expenditure on consumption declines as a result of the fall of employment in capital goods industries; and so the income stream shrinks still further.

It then follows that a society geared to a high level of capital-goods production is likely to experience violent fluctuation in income and employment. A high-savings economy will remain a highly dynamic economy, so long as it is able to experience great bursts of capital outlays on plant and equipment from time to time. Such an economy is then rapidly expanding and progressive in spite of its being unstable. But if it fails to find adequate investment outlets in plant and equipment for its new savings and for its depreciation allowances, it will lose its dynamic quality and become a depressed and stagnant economy, with a large volume of chronic unemployment. The high-savings economy can escape a fall in income and employment only through the continuous development of new outlets for capital expenditures.

Terborgh, however, believes that the stagnation thesis is a bogey without sound factual or theoretical basis. Prior to 1929, the time of the Great Depression, there was little or no evidence of senility in the American economy. And, as one swallow does not make a summer, so to borrow the expression, one depression, even as great as the Great Depression, cannot establish a presumption towards stagnation. On the specific

topic of income analysis along saving and investment lines, Terborgh also believes that the analysis taken by itself is essentially neutral and establishes no presumption in favour of stagnation. Stagnation or no stagnation will realistically depend on the relationship which exists between the potentialities of investment outlets on the one hand, and the magnitude of savings on the other. If the former falls short of the latter, stagnation will be the inevitable outcome.

If now the theory is in itself neutral, why then is Hansen a stagnationist? The answer is explicit in his views as to the future of saving. He believes that people tend to divide their extra income between consumption and saving. The creative genius of scientists and engineers can be expected to increase full employment real incomes at a rapid rate, and it is likely that real wages and productivity will continue to grow even faster than in the past. Assuming that people's tastes and standards of consumption remain unaltered, this rapid increase in real income will probably mean an even greater proportionate increase in saving. What is wrong in Hansen's concept of the long run development of a mature economy? It is the fact that his assumption of the constancy of consumption standards does not conform to reality. Fortunately, consumption standards do not remain constant. People's needs and desires are constantly expanding, because of new products invented, because of advertising, and because of social custom and imitation. As Paul A. Samuelson has pointed out,

throughout all America's history the consumption-income schedule has been shifting upwards; the propensity-to-save schedule has been shifting downwards. There are now pretty good statistical records going back more than half a century. These records show, rather than an increase in the ratio of saving to income, a remarkable constancy of the proportion which the American people have saved out of past full-employment incomes. There is no reason, Samuelson remarks, why the same should not continue to be true in the years ahead. If rising living standards keep pace with rising productivity, then the percentage of personal saving that has to be offset by investment need not get worse, especially if progressive tax and expenditure policies help to maintain a high consumption economy.⁽¹⁾

(b) ON THE INVESTMENT SIDE.

In the past, the principal determinants of investment have been such dynamic elements as rapid population growth, discovery and settlement of new territory, and technological innovation. But these dynamic elements, Hansen maintains, are lacking in the American economy of to-day: population growth is on the decline, the geographical frontier is no longer being pushed out, and technological innovation often takes the form of inventions that require smaller, rather than a greater, volume of investment. Each of these three pillars of Hansen's stagnation thesis will be critically examined in what follows.

(1) Paul A. Samuelson, *Economics, An Introductory Analysis*, Second Edition, pp. 404-5.

1. DECLINE IN POPULATION GROWTH.

It is not difficult, says Hensen, to see that a country experiencing a rapid increase of population requires a great capital outlay in order to provide housing, transportation and all facilities necessary for modern methods of living. The rate of population growth must play an important part in determining the composition of the flow of final goods. A rapidly growing population will demand a much larger per capita volume of new residential building construction than will a stationary population, whereas a stationary population, with its larger proportion of old people, may perhaps demand more personal services. The composition of consumer demand will have an important influence on the quantity of capital required. The demand for housing calls for large capital outlays while the demand for personal services can be met without making large investment expenditures. It is, therefore, not unlikely that a shift from a rapidly growing population to a stationary or declining one may so change the composition of the final flow of consumers' goods that the ratio of capital to output, as a whole, will decline.

In the past, population growth and territorial expansion opened vast outlets for extensive investment of capital. In the past, the Americans enjoyed opportunities for both extensive and intensive investment. Now extensive expansion is largely over, and there remains only the possibility of intensive expansion.

But both types have proceeded together, each reinforcing the other. Technological developments characterised the nineteenth century expansion, but population growth and penetration into new territory, in turn, played an important part in widening of markets, minimising the risks of technical progress and promoting the development of mass production techniques. In other words, extensive expansion has speeded up intensive expansion.

Hansen believes, in this connection, that the growth of population in the last half of the nineteenth century was responsible for about 40 per cent of the total volume of capital formation in Western Europe and 60 per cent of it in United States. If this estimate is approximately correct, then an important outlet for investment has been closed as a result of the rapid decline in population growth.

Terborgh's criticism here is both factual and theoretical. It is factual in the sense that, if economic stagnation is associated with low rates of population growth, there should be some evidence of this association, by comparing the rates of economic expansion in various countries with their respective rates of increase in population. Countries with low rates of population growth should be expected to have less dynamic economies than those with high rates. There are, in fact, indices of industrial production for a number of countries, beginning in 1880, and in addition indices of real income, beginning in 1911, for the detection of any significant correlation between economic

and demographic growth rates. This statistical test, however, has shown that there is no evidence whatsoever that countries with high rates of population growth have had, in general, any more rapid rise in their per capita production than others with slow population growth.

Terborgh's criticism is also theoretical when he refers to population growth in the abstract, as related to saving, on the one hand, and investment, on the other. On the first issue he states that, because a substantial fraction of all saving is motivated by investment in particular capital goods, that fraction vanishes when the need to purchase such goods ceases. If therefore a decline of population growth leads to a relative reduction of capital formation, this is accompanied by a partially compensatory reduction in saving. Furthermore, the change in the age distribution of the population should imply an increase in the number of retired people relative to the number of workers. This demographic change, however, would represent an increase in the number of those who are dissaving relative to the number of those who are saving. In consequence, a large fraction of the total saving of the community is absorbed in financing dissaving, leaving a reduced proportion to be absorbed in capital formation. In other words, a declining population growth tends to reduce both the volume of saving as a whole and the proportion of this reduced volume which is available for capital formation. These effects are considered by Terborgh to provide a partial explanation of the historical fact that the decline in demographic growth

rates has not been accompanied by the unfavourable consequences which are visualised by the stagnationists.

On the second issue, i.e. population growth relative to investments, Terborgh contrasts two opposing theories. First, a growing population, according to Hansen's theory, will give rise to both intensive and extensive investment, whereas a stable size of population will only stimulate the intensive type in the sense of providing an increase in the quota of capital goods per head. It is for this reason that investment opportunities will be more in the former than in the latter case. Secondly, before over-saving doctrines became popular, it was commonly believed that an economy which had to devote a substantial portion of its investment to supplying the annual increment of population would advance in per capita productivity and living standards more slowly than an economy which could devote its entire investment to maintaining and expanding its stock of capital goods per capita. The savings absorbed in meeting the demands of the increment of population were thought to be diverted, in part at least, from the task of promoting the average level of real income and standard of living. W.C. Mitchell, for instance, has treated the declining rate of population growth primarily as an opportunity for more rapid improvement in economic welfare. Stagnationists have reversed this argument. Intensive investment, i.e. the investment that goes to expand the stock of capital goods per capita, is not, in their view, competitive with extensive investment,

i.e., the investment that is needed to equip the increment of population with capital goods. On the contrary, they maintain that the intensive depends largely on the extensive type of investment in order to complete the absorption of savings and hence prevent economic stagnation.

Hansen may be right in generalising that, as far as investment prospects are concerned, population growth tends to generate investment opportunities that are lacking in its absence, and that an economy with a rapidly increasing population should have, *ceteris paribus*, a higher rate of capital formation than one which has reached demographic maturity. The annual increment of population must be supplied with its proportionate quota of capital goods, whereas the existing population already so equipped requires investment only to replace the current consumption of such goods; this is apart from the possible increase in per capita stock resulting from technical progress in both cases. But even though population growth provides an important quantitative source for investment, that in itself does not prove that investment would fail to go elsewhere if there were no population growth. Terborgh's final conclusion is that there appears to be no significant correlation whatever, positive (stagnation theory) or negative (other theory), between the rate of economic progress and the rate of population growth. But this final conclusion must be qualified if account is taken of the size of the available resources in the community concerned.

The correlation between the rate of economic progress and the rate of population growth may indeed be positive or negative; or, in other words, intensive and extensive types of investment may be complementary or competitive, depending upon whether the available resources in the country are adequate or not, relative to the size of the existing population. If the resources are inadequate, the price of population growth is costly, for the average living standard will tend to remain constant or even deteriorate, and in this case intensive and extensive investments will be competitive. If the resources are relatively adequate, the average standard of living will tend to rise, and here both types of investment will be complementary.

2. PASSING OF THE FRONTIER.

Throughout the nineteenth century, growth of population coincided with the settlement and exploitation of new territories all the world over, especially the United States of America. The development of those virgin areas called for heavy capital investment and provided a special non-recurring outlet for savings. With the passing of the American frontier by the turn of the century, the foreign capital that had poured into America to finance its economic development then turned to other geographical areas, e.g., Canada, Latin America, Africa and Asia, whilst the

U.S.A. herself gradually became a capital-exporting country, depending on foreign investment outlets for the absorption of a significant part of her savings. The mature economy theorists, however, believe that the future prospects of foreign investment outlets in outside frontiers will most probably not amount to much. They even go so far as to state that the inability of the Americans to compensate for the passing of their own frontier by large and continued capital exports for the economic development of frontiers elsewhere will greatly aggravate the American problem of finding sufficient investment opportunities.

But if the passing of the Western frontier, Terborgh argues, had created a dearth of investment opportunities, we should have heard about it long since. But there is no evidence that it did so. The first three decades following the disappearance of the frontier showed a slightly higher ratio of capital formation to the national product than the last three decades of the nineteenth century when the frontier was expanding. There is no historical evidence, therefore, that the completion of the first wave of western settlement impaired the functioning of the American economy, or that United States suffered from the passing of the frontier.

Terborgh, moreover, proceeds to clear up a misconception which is related to the significance of frontier development for saving and investment. The frontier development, he admits, clearly required railroads, highways, public utilities, houses, commercial

buildings, etc., but perhaps it is less clear that this investment was, from the viewpoint of its immediate effects, largely at the expense of capital formation in older areas from which pioneers migrated. In Terborgh's own words: "The settlement of the American frontier occurred during a period of population growth so rapid that the western movement merely drained off a part of the overflow without depopulating these areas. A migrant into the virgin territory therefore reduced by one the increment in the area he left. Had he stayed, he would have given rise to capital formation required in the home area to equip an increment of one worker with housing, consumers' capital and productive facilities. This is an important point. In a community of shrinking population, new workers entering the labour force can be supplied with productive facilities by taking over the existing facilities released by death or withdrawal of old workers, while new families can be housed in dwellings released by dissolution or withdrawal of old families. In a growing community, on the other hand, only a part of the new workers and families can be so supplied, the 'excess' of new workers over withdrawals and of new households over those dissolved require additional capital formation. Because migrants from other parts of this country to the frontier would almost invariably have constituted an increment to the population of their regions of origin had they remained, the question of the immediate effect of their migration on national capital formation is a question of whether the per capita stock of man-made capital

goods with which they were equipped on the frontier exceeded the per capita stock of such goods in older areas. For most of the period of western settlement, this question must be answered in the negative. The frontier was as a rule relatively poor, and though developing more actively in the creation of transport facilities, e.g., roads and railways, it invested less in other productive facilities, in housing and in consumers' capital than was invested in equipping a like increase of population for the east."

3. DEARTH OF GREAT NEW INDUSTRIES.

Finally, it has been stated by the stagnationists that the decline in population growth and the passing of the frontier combine to render the advancement of technology of much greater importance in maintaining investment opportunities. But, unfortunately, they believe that here, too, the situation is unfavourable. Such great new capital-consuming industries as the railroad, the electric lines or the automobile, which stimulated investments so considerably in the past, have long since come to an end, and no industry of such magnitude is yet in sight. It has also been stated by the stagnationists that there has lately developed a tendency for new inventions to be capital-saving, and not capital-consuming, so much so that investment requirements

as a whole have ceased to increase, relative to output. This tendency, they state, is characteristic of technological maturity. "Considering the economy as a whole," says Hansen, "there is no good evidence that the advance of technique has resulted in recent decades in any deepening of capital. Apparently once the machine technique has been developed in any field, further mechanisation is likely to result in an increase in output at least proportional to, and often in excess of, the net additions to real capital. Though the deepening process is all the while going on in certain areas, elsewhere capital-saving inventions are reducing the ratio of capital to output."

With reference to technical innovations in general, and great new industries in particular, Terborgh sees no reason why it should be assumed that these are merely things of the past. Innovations as such, making for intensive expansion, can be expected to continue with unabated vigour and potentialities. Hansen's argument, as Terborgh sees it, is simply that such industries come along irregularly, that their timing is a matter of accident, and that one of them may exhaust its impetus before the next one arrives, leaving the economy in a state of profound stagnation. In Hansen's opinion, therefore, the Americans were in such a state of affairs during the thirties and still are. It is important to note, however, that although this supposed gap between great new industries happens to be synchronous with the Americans' approach

to economic maturity, this temporal conjunction is purely fortuitous.

In addition, Terborgh points out that investment opportunities may be found not only in the initial innovation, but also in the subsequent improvements in it as well as in the replacement investment. The ability of a new machine to displace existing methods, depends not only on the extent and character of the original innovation, but also on the vigour of the flow of secondary innovations in the form of improvements. The railroad of to-day, for instance, represents an accumulation of thousands of separate innovations, most of them individually minor, but the cumulative effect of which has transformed the industry into its present advanced state. The same is true of motor vehicles, electric power, or telephone industries. These become great industries, not simply by virtue of the original invention, but because of long sequence of supplementary improvements increasing the value of the basic innovation and lowering its costs to users. These improvements took place not only in the basic line, but also in related lines. In the case of the automobile, for instance, there can be found improvements in motor vehicle manufacturing as well as in rubber, in petroleum technology, and in highway construction. Indeed, parallel improvements in allied fields are often a pre-condition of advance in the main field itself. But while capital formation as a whole derives its expansion

chiefly from the growth of investment in innovations in the dynamic stage, it should not be assumed that such a growth represents entirely a 'net' gain. The invention of wireless or the multiple-message cable all economise on the considerable amount of investment required in capital installations. The development of motor transport in the 1920's minimised the need for more railroads and huge related capital equipment. Atomic energy may minimise the need in many parts of the world for costly hydro electric projects. Science gives and takes as far as investment is concerned. On balance, however, general innovations certainly create more capital formation than they obviate or prevent, and an increase in the rate of innovation is automatically an increase in investment outlets for the absorption of savings.

This sort of analysis has led Terborgh to put forward his final proposition that, since neither innovation in general, nor the rise of 'great new industries' in particular, is held to be affected by economic maturity, we are dealing indeed with a factor accidental from the standpoint of the theory of maturity. There is no evidence, he stresses, that the great industries so often cited by stagnationists have had a combined influence on investment any more dynamic than has the aggregate of lesser innovations. This is significant, for as technology advances, there is a tendency toward an increasing multiplicity and diversity

ous examples of earlier times. (1)

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CHAPTER 8.

THE MODERN THEORY

IN RELATION TO THE UNDER-DEVELOPED ECONOMY.

It is now time to recapitulate what fields of study have been pursued so far. These studies have begun with a preliminary discussion of the meaning, scope and object of the new treatment of the theory of economic development. Its scope is the whole world, for it deals with a major economic problem which is common to every country, and its object is the study of the problem of how to increase material wealth, maximise economic welfare and raise the average living standards in a dynamic economy with resources and conditions changing all the time. In other words, it is the study of the causes of economic progress and stagnation in the dynamic sense. This new treatment of the theory conceives of a hypothetical society which is supposed to pass through successive stages of development; and in each stage the relevant data, their development and their effects on the level of economic activity are collectively tackled and analysed. It is thus a mere hypothesis in relation to which the following four sets of questions have been posed: Under what circumstances does economic progress emerge? What policies promote progress? Does progress generate a momentum? Is decay inevitable?

Broadly, the first part of this work has dealt with the

classical and pre-classical economists' views as to the causes of material progress, or specifically the policies which are designed to increase the country's wealth. It has been pointed out that, whereas the prime policy of the mercantilists was to foster and develop manufacturing industries and bring about a permanent favourable balance of trade, the encouragement of agriculture became the chief aim of physiocratic policy. Unlike the mercantilists or the physiocrats, Adam Smith saw in labour the source of all wealth, and argued that an increase in wealth would be dependent on the productivity of labour. Division of labour increases this productivity, but it is limited by the extent of the market. Smith was therefore a free trader; as for him foreign trade was nothing but an extension of domestic trade. J.S. Mill, for his part, visualised a policy for social and political reform, recommended the promotion of agriculture by all means, and conceived of a legal framework that could be so formulated as to govern economic activities in the best interests of the society. But with Malthus the root cause of poverty was overpopulation. Hence his main policy was to check the natural increase in population, but he restricted himself to moral restraint only in the sense of deferred marriages. Unlike Malthus, however, J.S. Mill preached for birth control and moral restraint before and after marriage. Accordingly, the classical and pre-classical economists concerned themselves with such policies as were related to the relative

importance of different types of economic activity, the productivity of labour and size of the market, the legal framework, and the problem of overpopulation. Such topics will crop up later on in dealing with the economic development of under-developed countries.

However, it was with Malthus that the first attempt was made to investigate whether the economic system develops its own laws of motion, and his reasoning related changes in the size of population to changes in the level of real wages in such manner that real wages would in the long run be pegged at the subsistence level. It is in this sense that Malthus inserted the concept of secular stagnation into his population thesis. Ricardo then took this conclusion as a premise upon which to build his dynamic theory of falling rate of profit, the gradual decline of which would become too sharp to support the capitalists. In consequence, accumulation would eventually come to a stop, and secular stagnation would be the inevitable result. Although Malthus and Ricardo differed in their views as to the causes of secular stagnation, this concept in itself seems to dominate their writings.

But whereas the first part of this work has been mainly concerned with the causes of economic progress, the second part has been primarily considering the causes of secular stagnation as dealt with in the writings of Marx and other modern economists. This more recent trend in economic thought, it will be readily observed, is

not novel. In a sense, it is a continuation of a drift of thinking in the classical tradition. Nevertheless, Marx completely refutes the Ricardian as well as the Malthusian theories of secular stagnation. He visualises that a capitalist society will not only be secularly stagnating, but will eventually collapse, and on its ruins will be set up a socialist society. On the path to this ultimate development of economic organisation, he envisages his well-known successive stages of development, leading in the end to the breakdown of capitalism when the expropriators become expropriated. But when Marx talks of the breakdown of the system, he means that economic progress comes to an end on account of the social structure itself, i.e., crises will be getting worse and worse until the periodical shocks to the social framework will ultimately burst it asunder and sound the knell of capitalism.

Fisher's contribution to the theory of economic development lies in his detailed study of the barriers to progress, i.e., the passive resistances on the part of workers and the active resistances on the part of employers to the transfer of resources as the result of the assimilation of available technical improvements. Fisher's analysis has led him to the conclusion that, if these serious obstacles which stand in the way of material progress were not removed, and hence the necessary transfers of resources were not made, not only would the average level of income fail to rise as improvements in efficiency of production would warrant, but the

failure to make such transfers would also mean the loss of the individual or group security which is usually the object of the resistances to structural readjustments. John Hilton and other authors supplement Fisher's work by investigating the active resistances which are alleged to be made on the part of trade unions as representatives of different sections of labour. The results of the impartial enquiry made by these authors have shown that the obstructions to industrial efficiency set up by the working class are not so serious as is commonly alleged, that restrictive practices imposed by trade unions are indeed fewer than they were and of less importance.

Finally, Hansen comes along to point out that in a progressive economy there is a tendency for saving to outrun investment outlets. His stagnation thesis is principally based on four components. It starts with an interpretation of the general relationship between saving and investment as being the determinants of the level of the national income. Three conditions are then held to constitute economic maturity in the sense of bringing forth the dearth of investment outlets: the decline in population growth, passing of the frontier and the dearth of great new capital-consuming industries. Meanwhile, savings pile up as idle funds for which there is no outlet in new physical capital. Excessive savings coupled with a dearth of investment opportunities mark the beginning of secular stagnation and recurrent crises from which

there will be no escape except through expanding public investment or taxing out of existence the excessive savings which poison the economy. According to a new school of fiscal theorists, fiscal policy, in such a period of secular stagnation, must be expansionary much if not most of the time. Over the business cycle as a whole, the budget might not be in balance, because the lean years would outnumber the good years. As national income grows, so too might the public debt. All this is still debatable, and many eminent economists are still opposed to any policy of continuous deficits.

1. THE MEANING OF STAGNATION IN MATURE AND IMMATURE ECONOMIES.

Now if this is the contribution of the modern economists to the theory of economic development in so far as the economic causes of stagnation are concerned, what fragments in their contribution may well be considered as pertaining to the study of the under-developed economy? Before any attempt can be made in this respect, it is worth while to clear up a common misunderstanding as to the meaning of 'stagnation' in a 'mature' economy which is industrially well advanced and in an 'immature' economy which is predominantly agricultural and comparatively much less advanced. In the case of the mature economy, it is not the growth of the productive potentialities that is believed likely to be stagnant. The secular

stagnationists believe that productivity and production may grow incessantly, doubling at every generation. The only thing that they think is likely to stagnate, if nothing is done about it, is the ability to keep everybody employed so as to realise full potentialities. To put the matter differently, although the aggregate national income and per capita income tend to be secularly increasing, the level of the full-employment national income schedule will most of the time be higher than the level of the actual national income schedule. The discrepancy between the levels of the two schedules, i.e., the potential and the actual, would then represent stagnation, or chronic unemployment, of some of the productive resources in the mature economy as a result of the unfavourable disequilibria between saving and investment in the ex ante sense. In point of fact, the last few years following the end of hostilities have proved to be quite the reverse of any gloomy expectations concerning the stagnation of a mature economy.

In the economics of under-development, stagnation has a really different meaning. An immature economy is that in which both the aggregate national income and the income per head in real terms show a secular tendency towards stability at relatively low levels or sometimes a decline. This secular tendency would imply no prospects of improvements in the level of living, or even a decline in it, even though productive potentialities might not be lacking in such an economy. In other words,

the under-developed or immature economy may have good potential prospects for using more capital, or more labour, or more available natural resources, or all of these, to support its present population on a high level of living, or, if its per capita income level is already fairly high, to support a larger population on a not lower level of living. This statement of economic immaturity would readily provide us with a sort of definition of the under-developed economy, which seems most appropriate in putting the primary emphasis on per capita levels of living and on the issue of poverty and prosperity. Even some economists like Viner prefer this definition on the grounds that it leaves room for secondary emphasis on quantity of population.⁽¹⁾ On the basis of this definition, a country may be under-developed whether it is densely or sparsely populated. The basic criterion then becomes whether the country has good potential prospects of raising per capita incomes, or of maintaining an existing fairly high level of per capita income for an increased population.

It may be thought useful to consider the case of the under-developed economy for the sake of comparison with the well-developed economy. The two have one thing in common. In both cases, productive potentialities are not realised in the full sense; in both cases stagnation is associated with the idleness of a lesser or a greater part of available resources, whether it be labour,

(1) Jacob Viner, *International Trade And Economic Development*, Oxford, 1952, p. 98.

capital, or natural resources. In the one case, however, stagnation is paradoxically progressive in the sense that it is associated with rising national incomes and per capita incomes; in the other, stagnation is associated with almost stationary, or perhaps declining, per capita incomes at comparatively low levels. In the one case, the level of living shows a tendency towards a secular rise in spite of the predominance of secular stagnation, whereas in the other case the level of living is almost always constant or even deteriorating. In the one case, chronic unemployment is 'open' and industrial, whereas in the other case it is usually 'disguised' and rural.

2. STAGNATION THESIS FROM THE VIEWPOINT OF THE UNDER-DEVELOPED ECONOMY.

If the stagnation thesis has perhaps left behind it a gloomy atmosphere and disappointment in the future prospects of the Western economy, it should have left an opposite impression of the future prospects of the under-developed economy. As has been pointed out, this thesis is based on the general relationship between saving and investment in the mature economy, as being the determinants of the level of the national income, and on the concept of chronic over-saving unaffected by the dearth of investment outlets. Such poor prospects of investment opportunities are believed by the stagnationists to be conditioned

by the decline in population growth, passing of the frontier and the dearth of great new inventions.

It is well to bear in mind, in this connection, that by far the major problem of capital formation on its supply side in the under-developed economy is the paucity of capital resources which is largely due to the very low incomes of the masses of the people. On the saving side of the stagnation thesis, therefore, there is no possibility that savings will poison the under-developed economy. On the contrary, any increase in savings by way of saving incentives on a voluntary or a compulsory basis may convert a capital-poor into a capital-rich country.

The next point to notice is that, on the investment side of the stagnation thesis, there are again no signs of decline in the rate of population growth, but on the contrary there is a steady increase. Following the stagnation theory, a growing population will give rise to both the extensive and intensive types of investment in the under-developed economy; but this is of course on the assumption that the available resources in the economy are adequate relative to the size of the existing population. Besides, there is no fear of the passing of the frontier in the sense in which Hansen has defined in his thesis, since the settlement and exploitation of new territories in the Eastern under-developed economies have by no means been completed. There is still a great scope for the development of spacious virgin areas in Africa, Latin America and Asia, and this will call for heavy capital

investment. Finally, the more backward a country is in its techniques of production, the greater is the field for technological progress. A country with the most modern processes can advance farther only by new inventions and discoveries. A country which is backward technologically can make great advances merely by borrowing from the already existing stock of knowledge. All of these factors are favourable indices to show that, by reversing the arguments of the stagnationists, there can be economic progress rather than permanent stagnation or retrogression in the under-developed economy.

3. BARRIERS TO PROGRESS IN CONNECTION WITH THE UNDER-DEVELOPED ECONOMY.

Furthermore, Fisher's and Hilton's works, which contain evidence of the existence of some barriers to progress in a well-developed economy can scarcely be of any relevance to the under-developed economy. Whereas the desire for a decent standard of living and a certain degree of security is the common aspiration of all workers in the broad sense of the word, the statutory regulation of conditions of work has been regarded as the most certain method of achieving this aim in an under-developed economy. In India, for instance, labour legislation has been the substance of the protection enjoyed by labour. The Payment of Wages Act seeks only to ensure the regular payment of wages and to prevent

the exploitation of the wage earner by arbitrary deductions; it does little to help the worker with no bargaining power to secure a living wage. This gap has recently been filled by the Minimum Wages Act, 1948, which may rightly be described as a new landmark in Indian labour legislation. (1)

Parallel with the social progress which may be expected to result from statutory action, the workers themselves in an under-developed economy may have another means of striving for greater freedom and an improved status. This means is association, of which the most effective form is association in trade unions. But trade unionism in the western sense of the term is a recent feature of the industrial life in many under-developed countries. The right to organise trade unions has recently been recognised in many such countries. In China, for instance, the workers' right of association has largely been extended in recent years. (2) The legal status of the trade unions in Iran is governed by the Labour Act of 1949, which lays down that wage earners employed in the same undertaking may form a trade union, and that unions for the same trade may form a federation. (3) In India, the Trade Unions (Amendment) Act of 1947, provided for the compulsory

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- (1) International Labour Review, A Decade of Labour Legislation In India, 1949, p. 506, seq.
 - (2) International Labour Review, The Labour Policy of the Chinese Government and Its Reaction on Industry and Labour, by Professor Ta Chen, Vol. LIX, No. 1, January 1949.
 - (3) International Labour Review, The Trade Union Movement in Iran, 1951, pp. 180-181.

recognition by employers of representative trade unions by order of a labour court. (1)

As a rule, the existing trade unions in most of the under-developed countries are not yet well enough organised to be of much service to their members. Broadly, their main activities are more or less cultural and recreational. The inability of most of them to discharge their duties properly demonstrates the ineffectiveness of this agency in promoting the general well-being of the working classes.

If these conditions have prevailed in most under-developed countries, it is natural to ask whether there are any special reasons why trade unions in those countries have failed to improve the status of the working classes. The first is to be found in the fact that trade unionism, in theory and in practice, is a foreign concept which few labour leaders and workers understand and appreciate. The activities in which many unions engage are but a superficial imitation of their western counterpart. About the true nature and functions of the leading unions in the western world, little is in fact known.

Conditions are unfavourable in another respect; for, in many instances, trade unions have been subject from the outset to political influences. The direct or indirect intervention of the public authorities concerned, aiming at keeping the workers'

(1) International Labour Review, Trade Union Legislation In India, 1949, p. 510.

organisation free from foreign influences, is bound to hamper the free and effective development of trade unionism in the Eastern world.

Besides, the success of a trade union movement largely depends on the spread of education, the acquisition of experience in trade union work, the feeling of solidarity among workers and the real understanding of the idea of industrial democracy. These elements are not yet strong enough to bring about a vigorous labour movement of the western type.

This being granted, there is not the least fear of obstructiveness on the part of trade unions in most under-developed economies. The defensive fortress of restrictive practices in the sense in which they are known in the West has not yet been established. That condition does not obtain to-day and is far ahead in the future. Trade union movement in the East has no inherited skill, experience and capacity that are needed to strengthen its bargaining power and to struggle for larger shares of existing wealth. If in Fisher's and Hilton's sense, there may be some barriers to progress in the West, there are none in the East. If there have been all the symptoms of secular stagnation in the East, there must be some causes other than those embodied in stagnation theories which are only referable to a Western advanced economy.

4. THE MARXIAN SCHEME IN RELATION TO THE UNDER-DEVELOPED ECONOMY.

So far we have been discussing the contribution of the stagnationists to the theory of economic development from the standpoint of the under-developed economy. This is one point of view. Let us come to the other point of view which is based on the Marxian approach. In his scheme of things, Marx relates misery to the exploitation of labour in agricultural and non-agricultural countries alike. Marx indeed lays much emphasis on the evolution of capitalism in agriculture, showing how monetary rent is converted into capitalist rent when the place of the peasant has been taken by the agricultural entrepreneur, cultivating the soil with the help of wage labour. Such a primitive accumulation, as he calls it, 'sets free' the workers for the uses of industrial capital. The impoverishment and the ruin of the agricultural population lead in their turn to the formation of a reserve army of labour for capital, and the rural proletariat join the urban proletariat in their misery and pauperism.

Even the small peasant proprietor who escapes the continual move from the farm to the factory is also exploited by the capitalist. This sort of exploitation, as Marx believed, differs from the exploitation of the industrial proletariat only in point of form. The individual capitalists exploit the individual

peasants through mortgages and usury, and the capitalist class exploits the peasant class through heavy taxation. The capitalist is enabled to extract profit, interest and rent from the land while leaving the peasant proprietor to pay himself his own wages, and as a rule he hands over to the capitalist class part of the wages of his own labour.

Even the tenant farmers, the cultivators of the soil, are exploited by a landlord class which contrives to secure to itself the major part of any increase in agricultural yields without performing any useful social function. In the Marxian scheme therefore the cultivator of the soil, whether he be a wage labourer, or a small peasant proprietor; or a tenant, is exploited and the exploiter is the same: capital.

This dim picture of misery and exploitation is largely true of many under-developed countries. Land reform, abolishing the landlord class, and the creation of an effective machinery for relieving the small peasants of private excessive debts and mortgages would be the first step necessary for releasing the productive energies of the people. If private enterprise in the field of agriculture is to yield its best results, the private initiator must secure the fruits of his own labour. If agricultural progress is to be achieved, there must be no exploitation by the capitalist landowner or the money-lender in the Marxian sense. (1)

(1) C.f. Measures For The Economic Development Of Under-Developed Countries, United Nations, Department of Economic Affairs, New York, May 1951, Sections 56-57, p. 21.

Such is the contribution to the theory of economic development in the Old and New Economics. Very broadly, it touches upon the second, third and fourth sets of questions in the new treatment of the theory as defined above. Whereas the first part has been dealing with the policies which promote progress in an already developing economy in the classical sense, the second part has been dealing with secular stagnation in a well-developed economy in the modern sense. With this body of economic thinking in the background, it is then proposed to proceed with the main theme of this work; the circumstances under which economic progress obtains, and policies which promote progress.

But when considering conditions of economic progress it is essential to have some knowledge of the history, geography and sociology, which is relevant to the question. It is therefore well in order to begin with a preliminary discussion of the historical evolution of simple communities.

CHAPTER 3

EVOLUTION OF HUMAN COMMUNITIES

1. THE EARLY SETTLEMENT

Since all human societies must rest on an economic basis, geographical factors necessarily play an important part. The environment always prescribes the conditions under which man can earn their living. Under the impact of their environment, men have to co-operate with one another to ways which determine the form the community will take.

PART III.

Changes in environment, indeed, explain the diversity of human types better than any other hypothesis.

THE CIRCUMSTANCES UNDER WHICH

ECONOMIC PROGRESS OBTAINS.

In simple societies the interplay of "Place-work-Folk" is obvious enough. Given an environment so restricted that there is practically no choice as to means of livelihood we get a society which must adjust itself to "Nature". The most elementary forms of human society are found where life is supported without settlement on, or cultivation of, the soil. To live man has to wander; and consequently, he makes no permanent impression on his surroundings. As a nomadic hunter, he wanders over the vast steppes of Central Asia, or the tundra of the Arctic regions, or the lands of snow, following the seasons and the growth of grass. As a nomadic herdsman, he is developing, and his life is based on the basis of grass. The nomadic life is the only one that can accept these conditions.

CHAPTER 9

EVOLUTION OF SIMPLE COMMUNITIES

1. THE EARLY SETTLEMENT

Since all human societies must rest on an economic basis, geographical factors necessarily play an important part. The environment always prescribes the conditions under which men can earn their living. Under the impact of their environment, men have to co-operate with one another in ways which determine the form the community will take. Differences in environment, indeed, explain the diversity of human types better than any other hypothesis.

In simple societies the interplay of "Place-Work-Folk" is obvious enough. Given an environment so restricted that there is practically no choice as to means of livelihood we get a society which must adjust itself to "Nature". The most elementary forms of human society are found where life is supported without settlement on, or cultivation of, the soil. To live man has to wander; and, consequently, he makes no permanent impression on his surroundings. As an illustration, consider the vast grass-lands of Central Asia. The climate is characterised by a period of snow, followed by a short damp season suitable for the natural growth of grass. Other vegetation has no opportunity for developing, and whatever economy is established must rest on the basis of grass. The conditions are so strict that man must accept them; he is powerless to modify them. So he depends

on the grass-eating animals for his food, clothing, and shelter. He solved the problem by forming an alliance with the horse; this enabled him to round up and domesticate the cow.

Thus a simple community came into being, and its manner of life was strictly controlled. It had to move with the cattle as the grass was eaten. There was no appropriation of land, for when it was grazed it had no value. There was no accumulation of belongings beyond bare necessities and ornaments for the person, because they would be burdensome to people who were constantly moving. There were no specialised trades, because each adult male had to be able to turn his hand to any task. The group was an extended family, recognising the bond of kinship, and paying allegiance to the head or patriarch. It had to be large enough to tend its cattle, and yet not so large that the area of its temporary settlements was overstocked. When it reached a certain size it tended to split up. On the steppe the nomad adopted the pastoral life because he had the horse to help him. It was otherwise on the American prairie, where the horse was unknown until introduced by the Europeans; so that the Indians were hunters of buffaloes. Instead of the large patriarchal group, there was the hunting clan, in which the energetic young men had the advantage over the elders. The clan was unstable and did not provide a basis for a permanent social organisation.

The people of the grasslands, whether they are in the pastoral

or hunting stage, must be considered fortunate as compared with those who have to contend against the extremes of cold and heat. Human life should successfully withstand the rigours of the northern winter and here circumstances impose the severest of conditions. The climate limits the food supply, both vegetable and animal. The reindeer may be domesticated, but to supply its frugal diet it is necessary to keep moving. The parts played by horse and cow on the steppe have to be taken by the reindeer which is not particularly efficient in either role. While the horse can endure a considerable range of temperature, and has again and again brought the nomads into contact with settled communities, the reindeer cannot penetrate the forest belt. So the people are virtually confined to the north. While they are nomads, they cannot be purely pastoral nomads. To secure sufficient food it is necessary to resort to hunting and fishing. These activities tend to break up human society into small groups, each of which endeavours to supply its own needs. All their energies are directed to solving the problem of bare subsistence. Still, their fate may be considered happy compared with that of the peoples of the tropical forest. In the basins of the Amazon and Orinoco there is a vast extent of forest broken only by rivers. The area is subject to torrential rains at definite periods of the year. Excessive rainfall promotes the luxuriance of forest growth, but it is fatal to grass. In the primeval forest the animal life is mostly hostile to man. If he is to live, he must

be a hunter on a small scale, lurking in the thicket and pouncing upon such animals or birds as he can eat. Foresight is not demanded; for food for each day must be obtained on the day. In that climate he cannot make accumulations. The search for food is therefore a constant preoccupation. He often suffers hunger and sometimes practises cannibalism. All movements are difficult and dangerous, but permanent settlement is out of the question. He has no means of transport except the primitive canoe and picking his way through the undergrowth. In these circumstances human society is almost completely disintegrated. All the human types of society so far mentioned have at the best been waging a rather unequal fight. The people of the steppe have been the most fortunate, for through their reliance on the horse, they have been able to establish a permanent community on a patriarchal basis. But even they are subject to the imperious commands of Nature. They are doomed to wander, as are all people who live on the spontaneous products of the soil and the yield of the chase. Given the environment, progress is impossible, for these peoples must always remain what they have become, since they were caught in the web of circumstance. The essential distinction between these simple societies and the more complicated societies which have developed under more favourable conditions is that the one is nomad and the other is settled. To settle it is necessary to be able to cultivate the soil. External conditions no longer completely dominate the life of man.

He learns to modify them by his exertions and to provide for the future through his foresight. He becomes less dependent on Nature but more dependent on his fellows. The social organisation which arises is much more a matter of human will and design, for it rests on the relations between men who perform different functions in an increasingly complex society. Variety of employment offers opportunity for various aptitudes; there is no longer a level uniformity, but grades, classes and trades.

It is some eight or ten thousand years since one branch of the human race discovered the possibility and advantage of settlement. Geography determined the scene of man's earliest successes. Egypt is the creation of the Nile; without it the tract would be desert. But the great river, flooding with remarkable regularity, deposited rich alluvial soil in which it was possible to grow cereals in great quantities. The corn of Egypt could maintain a large population, provided advantage was taken of the annual inundation. So men settled, arranged their fields, and developed an irrigation system. They learnt to work in stone, and their skill in pottery, metal-working and building industries was remarkable. A great civilisation was evolved, and a settled government, with control of the whole area, was established. The ruling classes enjoyed a life of great luxury. No doubt public order and increasing wealth were associated with a condition of slavery for the mass of the people. So difficult is it for society to exploit the advantage of a favoured region

without placing an undue burden on the actual cultivators of the soil and other manual workers. Similar circumstances provided the basis for the successive empires which sprang up in the valleys of the Tigris and Euphrates. Here again, the rivers brought down alluvial soil, which when properly treated was remarkably fertile. Settlement led to the development of the crafts and the promotion of commerce. By desert routes, the valleys of the Nile and of the Tigris and Euphrates were brought into contact. These routes in due course developed sea extensions which played a great part in the growth of Mediterranean civilisation. The commercial greatness of Venice to the end of the Middle Ages was based on trade which came by these ancient routes from the East.

From these few illustrations we can gather some conception of the part played by environment in the growth of human societies. "Place-Work-Folk" is a formula which provides a means of interpreting the significance of any group. Place gives the environment, Work indicates what men can make of the environment, and Folk reveals how the environment has fashioned its inhabitants. ⁽¹⁾

2. THE SLAVE ECONOMY.

The shores of the Mediterranean Sea witnessed the development of the successive civilisations which have moulded the thought and defined the outlook of the West. Here the external conditions offered favourable opportunities for the settlement of,

(1) C.f. J.E. Rees, A Survey of Economic Development, p.14.

and the intercourse between, organised groups. There was a considerable degree of unity, because, when once men had mastered the navigation of the great inland sea, they had an easy means of intercommunication. The river valleys of the sea board were similar in general character, and colonists who left one place for another were able to reproduce communities on the model of their old homes. The natural products of the Mediterranean region are alike, and immigrants found that the soil was suitable for the extension of cultivation. The environment of the typical settlement may be resolved into three elements: the valley in which agriculture could be established; the port which could be made the basis of commerce; and the hills of the hinterland where pastoral life was maintained. The settlements mingled these three ingredients in different proportions. The valley life of these Mediterranean people probably represents traditions brought by settlers from the eastern banks of the Black Sea, where communities had early discovered the possibilities of cultivating the soil. So they were acquainted with a variety of trees, fruits and cereals. Naturally they would establish settled villages which would by degrees become fortified cities, for the cultivation of the soil demands concentration, and to defend its yield from marauding hill peoples defence is necessary. So city life became the chief characteristic of Mediterranean civilisation; it came to be conceived as the environment in which man reached his true stature. Instead of the family grouping of pastoral people

or the temporary alliance of hunters, there emerged an organisation, public and permanent, within which the individual had fuller opportunities for realising his capabilities. The older sanctions of force or custom gave place to the idea of law; a growing sense of public justice ensured to each full member of the community freedom to follow any lawful enterprise. Phoenicians, Greeks, and Romans were all city-dwellers. Their history is one of the confederation and rivalry of city-states. To their intense city life is due the development of architecture, art, literature, philosophical speculation, and legal conceptions.

The Phoenicians were predominantly traders. On the coast of Syria they founded the old-world ports of Tyre and Sidon, where they were in touch with the empires of the Nile and of the Tigris and Euphrates valleys. They were active in opening up trade routes by sea, and establishing centres where they bought and sold goods. They ventured to the shores of the Western Mediterranean, and even to the mysterious ocean beyond, bartering articles which appealed to the natives for the metals and other raw materials they required. Of their settlements in the West the most famous was Carthage which after the fall of Tyre (572 B.C.) became their chief city. They traded in weapons wrought in copper and bronze and in ornaments of gold and silver; they knew the arts of spinning, weaving and dyeing. But the strength of the Phoenician cities, i.e. commercial prosperity, was also their weakness. They neglected the agricultural basis. With

settlements far from one another and regarded primarily as markets, the Phoenicians could not solve the problem of stability. How to avoid revolution was a question which occupied the attention of the political thinkers of the Greek city-states. The presumption of Plato and Aristotle was in favour of a more or less self-sufficient state. This could only be attained by giving particular attention to agriculture.

In Greece, the early settlers had passed from the pastoral to the agricultural stage. At the dawn of history there are revealed communities cultivating the soil, and on this agricultural basis they built up a variety of crafts. Gradually the separate communities, divided from one another by the intervening hills, began to establish relations by sea. The villages had become urban centres before the beginning of historical record. They were ordered groups, dependent on the arts of peace in a world where violence was still rampant. The men of the hills were mainly engaged in cattle-rearing and had not forsaken their nomad habits; but they were quite prepared to make raids on the valleys and an aggressive military character prevailed among them. Sparta was an armed camp in which the ruling minority maintained control over a large subject population. In Athens commerce had naturally developed, for Attica was a peninsula with easy access to Asia Minor by sea. Its citizens enjoyed greater liberty, but its government was less stable than that of Sparta.

The interesting question is what kind of economic relations

existed between the different elements in these settled communities. Land was obviously limited in extent and appropriated for special cultivation; but it was not held in common. There was a large proportion of landless men who in some condition of slavery or serfdom did the agricultural work for a small number of rich landed proprietors. Whether the agricultural workers were conquered peoples or had been reduced to dependence by the burden of taxation or debt, the fact remains that settled cultivation of the land involved a hardening of social relations and the definite emergence of classes. Discontent sometimes threatened the stability of the city-state, and relief was sought either in emigration or in revolution in favour of the oppressed. In the crafts, and even in commerce itself, the same distinction between the full citizen and those who had fewer privileges was maintained. There was a tendency to relegate labour and trade to slaves and freemen. The intelligence of the Greeks was not applied to mechanical invention; and, apart from the development of the use of money, they played very little part in the elaboration of commercial methods. Apparently, when the city-states were at the zenith of their power, there was a considerable amount of trade, but it did not notably react on industry. It is possible to exaggerate the consequences of the institution of slavery; but no doubt its existence created an atmosphere unfavourable to the growth of the ideas which we regard as essential for the full economic

development of a community. What the Greek city-state made of its environment, then, was dependent on a number of factors, of which the most important was the conflict of different types. Successive waves of invaders imposed their will by conquest on the people they found in possession. It was not a question of a homogeneous people trying to find a solution to the problem of settlement in a region not hitherto appropriated.⁽¹⁾

In Rome also there was a blending of types. Situated in a more or less characteristic Mediterranean valley, the site of Rome invited settlers from the North side of the Tiber, and from the South as well as from the sea. The legends of Ancient Rome point to a mingling of different types: Etruscans, Latins and Sabines. They all became settled agriculturalists. The geographical situation was not suitable for the growth of commerce. It was by military power that Rome established its control over Italy, Greece, and ultimately the whole Mediterranean seaboard. The extension of the Roman Empire facilitated the spread of the ideas which had their origin in the city-states. A certain uniformity was thus given to Western Europe which it has never entirely lost. The weakness of this imposing structure was economic. Rome itself in the days of its splendour based its prosperity on the tribute which it exacted from its provinces. It never distinguished between plunder and commerce. For a great city, it was singularly unproductive, and had no firm foundation. Industry remained in

(1) *Ibid*, p.16.

the hands of small craftsmen, and mechanical invention made no progress. The wealthy accumulated capital, but there was no proper credit organisation by means of which it could find a variety of outlets. Capital was usually applied to agriculture, mines and forests. It was often invested in foreign trade, but practically not at all in industry.

Generally speaking, therefore, the Roman Empire did not achieve economic integration. Most trade was local. The articles that entered into wider commerce were luxuries demanded by the rich. Supplies of corn were obtained as tribute, i.e. without sending other goods in exchange for it. The crafts were often practised by the unfree, or by foreigners, and practically always on a small scale. But the extractive industries, metal-mining, quarrying, and particularly the cultivation of certain crops, did lead to capitalist enterprise. In the two centuries before the Christian era the growth of great slave plantations (latifundia) attracted much attention. The plantation often extended to thousands of acres. They offered opportunities for the investment of capital and were generally owned by those who had acquired riches in the exploitation of the provinces. How far this movement involved the decay of smallholding is not clear. That the conditions of employment were often most oppressive is demonstrated by the revolts of the slaves, the best known of which is that of Spartacus in 73-71 B.C. The facts that public land could be easily acquired and that the wars made slaves abundant

probably account for the establishment of the great slave plantations. In the long run the system was found unsatisfactory. From the economic standpoint, Columella, who wrote a treatise on agriculture about the middle of the first century of our era, recognised that slave labour was costly because it was wasteful. From the sociological point of view, "when rates of change are very discontinuous, it may well happen that one sector of the society cannot be meaningfully integrated into the social life of the community at all - so that, as far as that sector is concerned, society as whole no longer exists. The most extreme case of failure to achieve a balanced rate of change is that of slavery. It illustrates in its most terrible form the deliberate disintegration of established patterns of social and human values in order to pursue an immediate objective. Slavery not only detaches men and women by force from an established pattern of social relationships but, by using them as chattels for the ends of others, denies them both the opportunity to reconstruct a new society for themselves, and the right to become an integrated meaningful part of the society of their masters. In a society based on slavery the uneasy and unstable rule of force takes the place of that social harmony necessary for the full development of each part of the disrupted whole."(1)

(1) Prof. S. Herbert Frankel, *The Economic Impact On Under-Developed Societies, Essays on International Investment and Social Change*, Oxford, 1953, p. 24-25.

Nevertheless, large estates survived, and they were let out to free tenants. But freedom had not won a final victory. As the Empire entered into its decline, the free tenants fell into a condition of serfdom. They were bound to the soil, and the burdens of their payments increased. The causes of this reduction in status were manifold. Men surrendered their freedom to those who would relieve them from the burden of taxes or would protect them in times of growing disorder. They would engage to make payments in kind, i.e. agricultural produce, or to work for their protectors for so many days a week. So the Mediterranean civilisation which had achieved so much failed to secure permanent freedom for the masses.

In the year 622 A.D. the Moslem religion was born in Western Arabia, and a tiny Moslem state was set up. Within a century the armies of this infant state conquered the whole of Western Asia, North Africa, the Nile Valley, and even Spain in Southern Europe. Upon the conquered peoples they imposed their religion, language and culture.

Some sociological aspects of Islamic society, however, are so significant in themselves as to deserve a separate appraisal. Among these are such questions as the special nature of such a society, its attitude towards slavery, and the influence of religious traditions on the economic qualification of the society. A study of the foundations of Islamic society cannot ignore the

various meanings of the term "Islam", which may equally well signify a religion, a community, a State idea, or an entire congregation of Moslem peoples. The term, however, can be understood as signifying not only a system of religious elements or religious and political doctrines but, above all, that civilisation which, starting from Hither Asia, has created in the countries within its sphere a common culture and philosophy of life based on a uniform creed and a framework of ideas, political, social and State, derived therefrom. All these elements taken collectively, and in their vast spatial extent and spiritual power, constitute the substance of Islamic society stretching over lands and seas and based on a tradition embracing all spheres of life.

In the first centuries of Islam its teachings did not influence the state of society in the countries brought within its fold. The population of Arabia, apart from the urban settlements, was made up of a number of warlike tribes and groups held together by loose ties. These tribes were indifferent to religious ideas. Their social structure was determined by the clan as a unit. The patriarchal way of living among the Beduin tribes revolved, as in all primitive communities, round the family or clan. The individual is conscious of himself as a member of a certain family or clan, behind which background his separate ego and its claims and feeling completely recede. The spiritual world of the clan

member was conditioned by the concepts and forms which, by virtue of old tradition, regulated the life of the tribal society and its relations with the outside world. The individual was hemmed in both his mental and emotional world; his world of ideas was that of his group. The collective ideas of the clan were accepted by the individual member unquestionably as his own; his views were those of the clan to which he belonged. In the old tribal groupings are revealed a natural development in which the individual is automatically incorporated and is allowed to function solely as a part of such society. As in all primitive societies, the individual claims no status as such, but regards himself as a member of the society. He feels safe and secure so long as he is under the legal protection of his family, clan or tribe. Under the conditions of life in the desert and steppe, and in view of the absence of the legal apparatus of more developed civilised societies, this tribal protection could alone guarantee the security of the social organisation. It was with the forces of this integration and identification of the individual with the tribe and its self-imposed system of values that the new teachings of Islam had to contend.

Furthermore, the postulate of equality contained in the Islamic doctrine from the time of its original preaching at first found no acceptance in the Islamic society. Nobility of descent was a valuable asset in the social life of the Arab tribes. The

cult of their ancestry, pride in a long chain of noble forbears, was firmly ingrained in their consciousness; and as late as the fourteenth century this spirit of ancestral glorification prevailed among the tribes. In fact, no one could become head of a tribe who could not boast of a long and noble descent. For this reason the efforts of Mohammed, himself neither of high parentage nor a member of a particularly distinguished profession, were first directed to the establishment of a new society of equals. Rank in this new society was to be determined not by aristocratic descent but by faith. The antagonism of the old tribal nobility to Mohammed's proclamations was due in no small measure to the revolutionary break they entailed with Beduin social tradition, with its fund of time-honoured notions on the status of the individual and the family and the importance of descent for society. The dispute over the essential postulate of Moslem social teaching was not settled even in the centuries after Mohammed, although in the newly-forming society of Islam the Prophet's doctrine of equality asserted itself more and more as time went on. Up to the present time the demand for equality and the suppression of the old tradition of descent has not been realised in the sense desired in spite of its advocacy by the Prophet. Kinship with the Prophet, in fact even the slight degree of relationship deriving from the accident of belonging to his tribe, came to be regarded as the touchstone of true nobility. Thus whereas the revolutionary abolition of the old ideology of nobility of birth, although

accepted in principle, found little practical response in the Moslem world, the idea of a community of all true believers everywhere gained a firm hold. The Islamic doctrine, like the ideology of every religious mission, envisages the liberation of the individual from his isolated position and his union with his fellow-believers in one great community where he is offered the deep satisfaction of equal status by virtue of belief alone, and not through "external" values such as descent, material possessions and so forth. All followers of Islam possess equal rights and duties in this community to which one may be admitted regardless of sex, class, office or possessions; they feel themselves to be a great brotherhood of believers. Even the Khalif himself, the Prophet's representative, was occupying his high position of authority over whole countries and continents solely by virtue of his faith and the confidence of his followers. (1)

A further element which came to possess great social importance in Islamic society was the slaves. Slavery had flourished throughout the whole of Arabia, both in the towns and among the Beduin tribes. The importance of the slaves for the Arab society of that period was so great that Mohammed did not demand the abolition of slavery. The slave trade was an extremely remunerative branch of commerce and remained so right up to the nineteenth century. The social structure of Oriental countries,

(1) C.f. Alfred Bonne, *State and Economics In The Middle East*, London 1948 p. 327.

particularly the management of the household, was extensively based on slave labour so much that, though the abolition of slavery became the watchword of the European powers a hundred years ago, the custom has continued to flourish in the Arab and African countries practically up to the present day.

In the eyes of Islam the position of slaves is not so degrading as it might appear to the European observer. Apart from the fact that the Koran itself ordains that slaves be treated humanely, their acceptance of Islam in a society in which the brotherhood of all believers should play an essential part likewise guaranteed them a more dignified position, although the actual fact of servitude, the legal status of slaves, was not abolished. Thus the inner sense of equality and their claim to religious brotherhood provided the Moslem slaves in many cases with opportunities to rise in the social ladder and even brought them to the very highest positions in the State. In point of fact, a great number of slaves during the period when Islam was spreading exercised the highest of political authority and even formed ruling dynasties, among which were the royal house of Delhi and the dynasty of the Mamelukes. This very position of the slave, his lack of relations and isolation from influences rendered him particularly fit for the execution of the plans of his master. This fact often resulted in the more talented of the slaves acquiring a position of intimacy with the rulers and finally themselves attaining to important positions in the State.

But equally the legal status of the slaves has, according to Islamic theory, always been extremely limited. Islam took over the pre-Islamic practice of declaring property in the form of slaves to be acquirable by purchase, donation, inheritance or capture. In early Islamic times the possibilities of acquiring slaves by capture applied only in respect of unbelievers, while it was likewise contrary to the law to sell believers for one reason or another into slavery. Thus the patriarchal structure of Arab society led in practice to the complete admittance of the slave into the household or family community just as the advocated humane treatment of slaves was general. The law is on the whole stricter in this respect than the practice. According to the law slaves are expressly treated as 'movable goods' and may be freely bought and sold, exchanged, given in security or hired out. As regards their physical needs they possess the same rights as domestic animals, i.e., the right to board and lodging, an appropriate measure of work and, in particular, an interval of rest during the summer holidays. Slaves may not own property, and everything they acquire reverts to their masters. A slave, therefore, may not engage in any independent trade but only act as his master's representative. Marriage is allowed only with the consent of the slave's owner.

The sociological importance of the slaves is reflected in their political function as bodyguards to the great Emirs, and their suitability as high ranking state officials, and secondly in their

emergence as independent tribes. Undoubtedly the fate of Emir families was often entirely dependent on the existence and intervention of the slave bodyguard. Their suitability for this calling arose from the fact that they were in practice uninterested in the family disputes of the tribes and were an absolutely reliable and efficient tool in the hands of their masters. Moreover, the rise of individuals as strong personalities from the rank of the slaves can be explained by the fact that they were readily entrusted with important functions which it was not desired to hand over to directly interested freemen. The freeing of former slaves and their formation into tribes with their own chief, herds, and land is likewise an important feature in the general picture of Islamic society.

The fundamentals of early Moslem society may thus be summarily restated. The family or the clan, as the case may be, is the nucleus of Moslem society as established on a patriarchal basis. All members of Moslem society are co-equal, and the management of the social groups in the community is governed by democratic principles. Women have equal rights with men, with the exception of certain legal disadvantages in respect of property and inheritance. Slavery is tolerated in practice, and though emphasis is laid on the equality of the slaves as human beings, such an institution is well recognised as legitimate in Islamic theory.

3. THE PRIMITIVE PEASANT ECONOMY.

The first impression that one receives on coming into contact with the rural life and forms of agrarian society in Middle Eastern countries, near and far alike, is one of broad external similarity or even uniformity. Even though pronounced differences may exist side by side within each single community, according to the nature of its soil and water supply, the aridity of the climate, with its long rainless summer and the need for artificial irrigation in rainless areas, has produced similar conditions of vegetable life and of production over wide zones of the Orient.

To these natural factors in stationary agriculture should be added a number of other factors of social, political and legal nature which have also tended towards uniformity e.g. the Moslem code and philosophy of life, Islamic legal institutions, and the effects of the feudal social order. In addition, there was the Ottoman regime which for centuries had grouped those areas together, imposing upon them both its rulers and its political and administrative institutions. Furthermore, the links of language, intensified by the religious factor, brought the peoples of these lands closer to each other. All these factors have tended to create, in spite of the differences that exist, a social structure permeated by many similar elements.

Nevertheless, a general uniformity in the stratification and development of such agrarian societies is in no way complete. Account must be taken of the social divergences which do exist

between farmers and townsfolk, landowners and tenants, settled population and nomad elements. More important as a factor of deviation are the differences which result from the prevailing systems of agriculture conditioned by Nature.

For anyone with a sense of history visiting the lands of the Middle East for the first time, the impression of an arrested development, of a gap in the course of historical progress, or indeed of a retrograde movement, is the essence of an experience which has been bound up with the word 'Orient'. As a matter of fact, impressions of this kind would apply to almost all Oriental countries. In the centre of the Oriental town, the stately buildings, constructed in a spurious Oriental style, may convey a certain bigness of conception. But in the immediate neighbourhood of noble edifices, one would notwith surprise the very low state of housing and building conditions with a correspondingly inferior standard of living. In the countryside, the forms of settlement, established many centuries ago throughout most parts of the Orient, show no appreciable difference from those of to-day, just as agricultural techniques have undergone no important change. The thousand-year old Eastern nail-plough still leaves its trail across the fields; still can the ox be seen turning the old water scoop-wheel. The farmer is everywhere living a life of almost unsurpassable frugality based on exploitation both of the soil and of human exertion. It is a way of life which can only be interpreted through the extreme traditionalism which has indeed

invested the agriculture of the Orient with its own specific stamp.

Besides in the E.C.A.F.E. region, agrarian societies reveal almost the same picture conveyed to us by the constitution of economic society in the Middle East. They show more or less the same basic characteristics as are peculiar to the Oriental countries in general: a stationary agriculture along with a rapidly growing population pressing heavily on the means of subsistence; a low hygienic and educational level which manifests itself in high mortality, widespread disease and low literacy rates; a paucity of known mineral resources; a marked concentration on agriculture; a great shortage of capital; and a lack of technological advancement. All these characteristics result in very low productivity and low levels of income, the social consequences of which are aggravated by the very uneven distribution of wealth and income.

We are even told by the anthropologists that there do exist in the remote places of Africa and Asia some primitive communities which are almost out of contact with the outside world. These communities have scarcely been touched by Western civilisation and have led the most primitive of human life and enjoyed but the most humble of human culture. Many are peasant systems, much more backward and immature than those obtaining in the Middle East, with money used for a limited range of transactions, a very simple technology with hardly any machinery, and methods of enterprise, co-operation, credit and income widely divergent from those in a

Western economy. Others of these peasant systems are truly primitive, with no monetary medium at all to facilitate economic activity in the spheres of production, distribution and exchange. Those types of society are taken to differ so fundamentally from 'European Culture' as to merit the term 'primitive'.

Thus over the wide zone of the Orient, almost all peasant systems, from the most primitive to the relatively more advanced, are basically characterised by stagnant agriculture and the most deplorable of social conditions. The question now arises, what are then the real causes of secular stagnation in such agrarian societies?

CHAPTER 10.

THE AGENTS OF ECONOMIC PROGRESS.

Principles of economic theory may be conceived as universally applicable to both a primitive and an advanced economy. But the social and moral design embracing economic relations and activities in the former is widely divergent from that in the latter type. In all types of society, however, social ends and values, the legal, religious and political framework have bearing on the economic organisation. Any social relationship, any aspect of human life, can be shown to have its economic impact. It is only by studying these social relationships that one can properly understand the way in which an economic system does in fact work. It is only against a background of knowledge about the social framework in a peasant society that a study of the causes of stagnation and progress can best be pursued.

In the pursuit of such a socio-economic study, however, reference should first be made to a serious qualification. Historians have often declined to consider the possibility of building up a theory of economic development. They have assumed this attitude on the grounds that it can hardly be possible to prove the validity of such a theory in a historical way. The difficulty involved in making use of history scientifically lies in the fact that it is not sufficient to pick out one or two historical events in order to prove the validity of the theory, but

it is necessary to go further afield and prove the validity of the theory throughout the history of mankind in different places and at different times. This attitude, however, should not deter us from investigating, as far as possible, the tacit assumption that the record of history is a record of stagnation, that stagnation is the normal state, even though it is interrupted by fits of economic progress.

To begin with, the ruling class in a society is in fact responsible for keeping things stagnant. Only the very primitive societies are based on a purely egalitarian basis. Most of these societies are based on the minority's ownership of land, capital, or even slaves. By ruling class is here meant the aristocracy of a society who have the exclusive right to rule and govern. Religion as an institution is very often tied up with the ruling leisure class, supporting it and the status quo. This is all the more important from the standpoint of those who rule and govern for control over religion means control over the minds of the people. But an interesting question here presents itself: Why is the ruling class inimical to progress?

Where innovations create wealth but in the meantime destroy it by frustrating existing investments, it is therefore always in the interest of some people to resist these innovations. But if they create more wealth for some members, then the class as a whole may not resist them. Innovations which frustrate the wealth of all members of the class, are only those that can meet, and are bound

to meet, resistance all-round. Consider, for example, the rise of industry in Medieval Europe alongside the expansion of trade and the growth of towns. Towns attracted the serfs who were tied to the land under the manorial system. As it was impossible to build up an industrial capitalist system without attracting away labour from feudal lands, it was only natural that the feudal lords should have resisted that change. As it was incompatible with the growth of the new capitalist system, feudalism was bound to be abolished in spite of the resistance of the feudal lords.

The ruling class in the Roman Empire, based as it was on serfdom or slavery, on the entire exploitation of human labour, had also no interest in labour-saving innovations so long as it had the slaves as part of its property. It was also with the Greeks (600-300 B.C.) that slavery as an institution became the cornerstone of the economic organisation. The ruling class was thus bound up with the then existing techniques of production. Any changes in techniques, which might be detrimental to the interests of the class as a whole, were bound to meet with consistent resistance all round.

1. THE THEORY OF THE CREATIVE MINORITY.

Who are then the agents of economic progress? This question should bring us to the theory of the creative minority. New progress is but the product of new men outside the circle of the ruling class. They seize new opportunities and resist the

opposition of the dominating members of that class. For instance, the rise of trade and the growth of towns in the Middle Ages was the work of runaway serfs and minor members of the society. The same proposition is true of nineteenth-century Japan. In 1868, a revolution in the form of government came about with the result that the old ruling class was ousted from power, and a new class arose setting up a new society of its own. Thus the Meiji era began and with it the career of Modern Japan after the disintegration of the old regime. After the Restoration in 1868 the control of the central government rested, under the Emperor, in the hands of those vigorous leaders who led the revolt against Tokugawa. Rapid changes in the technical equipment and the economic organisation of society were achieved as the result of the deliberate policy of the new ruling class. To quote Allen:

"Yet if Japanese society was moved by ancient traditions, in the middle of the nineteenth century it was in a condition which made it receptive of stimulus from the West. Moreover, if it was constituted so as to be capable of providing the country with a ruling class that possessed prestige and self-confidence, that class was not rigidly demarcated from the rest of the population, nor was it conservative in its outlook. Men of talent found opportunities to enter it, and many of its members were themselves avid for change in the ordering of their country's affairs. The mass of the people were docile in the presence of acknowledged authority, and in every class there was a capacity for co-operation

and organised effort which was in part the product of a long experience of a group action in the family, the clan, and the guild. This society, while it often threw up men of strong personality and will, yet usually contrived to ensure that their activities were subordinated to the interests of the group or the nation as a whole."⁽¹⁾

Similarly, in the history of medieval England, the Tudor kings, Henry 7th and Henry 8th were pursuing a policy of backing up the upstarts in the English society, new men who were but the spurs to its progress. We are told, too, by historians that the Ottomans so suddenly emerged in history at the beginning of the fourteenth century, so suddenly established the Ottoman Empire which so extended far and wide, in fact as far as Hungary, that they were governing peoples the majority of whom were non-Mohammedans. How did such a great Empire come into being? In 1360, slaves and Christian boys, it is stated by historians, were stolen and went through rigid education and training for public administration and government of the different parts of the Empire. New blood was therefore injected into Turkish society; new men of a different race and of an originally different religion became, in fact, the real governors of the Moslem and non-Moslem territories under the Ottoman rule. British imperialism, however, put itself behind the princes in the colonies; it was a system of indirect

(1) G.C. Allen, A Short Economic History of Modern Japan, 1945, p. 156.

rule behind tribal chiefs. It looks very odd that British imperialism should be of such a type. By contrast, French imperialism is said to win over new men who were brought up within the French pattern and were then made the ruling class in the different territories of the Empire.

2. THE ROLE OF THE FOREIGNER.

Usually a very influential factor, bringing forth a change in the social structure, in the social ends and values, is provided by the emergence of the foreigner in the under-developed society. The Chinese, the Indians, the Japanese and the Egyptians, all alike, have witnessed that economic progress can be initiated and enhanced through the influence of the foreigner who brings with him new ideas as well as new opportunities for trade and civilisation. And, once a country is opened up for foreign trade, opportunities for specialisation and wealth are subsequently created.

In Malthus's view the foreigner even develops new tastes and enhances the demand of the people in less advanced communities for new things hitherto unknown to them. The people's desire to work harder in order to satisfy themselves with these new demands is held to be brought about at the instigation of the foreigner. In Mill's view, the economic advantages of commerce are surpassed in importance by those of its effects which are intellectual and moral. A great value is placed on the idea of putting human beings in

contact with persons dissimilar to themselves, and with modes of thought and action unlike those with which they are familiar. Commerce is the principal source of this contact, and commercial adventurers from more advanced countries have generally been the first civilisers of barbarians. Commerce is the purpose of by far the greater part of the communication which takes place between civilised nations and such communities, and has thus always been one of the primary sources of progress. There can hardly be any nation which does not need to borrow from others, not merely particular arts or practices, but essential points of character in which its own type is inferior. ⁽¹⁾

Historical evidence of some countries in Europe, Asia and Africa show pretty clearly that, whenever the foreigner emerges in a society, he carries with him a new agency of economic progress. This is quite obvious in the case of China. Up to the middle of the sixteenth century this country was ahead in innovations and standards; but then towards the middle of the seventeenth century the Chinese turned against the foreigners, breeding an all round anti-foreign feeling. The Chinese Emperor himself embarked upon a policy of persecuting the Catholics and compelled the Russian and European merchants to confine their activities to one port, Canton. This fanatical nationalism slowed down the wheels of progress, and finally stagnation set in to the detriment of the interests of the

(1) J.S. Mill, Principles of Political Economy, 7th Edition, 1871, Book III, Exchange, Chapter XVII On International Trade.

country itself. The Chinese turned inwards, severed relations with the foreigners, and through their own unwise action stifled the progress of their economy.

It is perhaps more pertinent to this historical study to draw attention to Medieval Spain as another case in point. This country, appeared in Medieval Europe as one that had the gold and riches of the world, supplied from the newly-discovered mines in its colonies. Nevertheless, Spain as a great Empire afterwards passed from the scene and faded away in history. It is only natural that most people should then give a high place to the inquisition in the downfall of that Empire. As soon as the jews and other foreign elements were expelled from Spain, this historical event should have forbidden any future prospects of Spanish economic development.

The story of Japan is entirely different, for this country did welcome the foreigners and accept Western influence. After the disintegration of the old regime and the Restoration in 1868, Japan gave at that time little promise of her future development, save in the determined way in which her leaders faced their difficulties. As Allen has pointed out, some foreigners in Japan contemplated with complacency the mediocrity of achievement which the future promised, and emphasised that Japan would never become a wealthy industrial country. The Japanese were known to be a happy race, and being content with little were not likely to achieve much. The love of indolence and pleasure of the people

themselves should have been a deterrent to economic progress. True, in 1867 the Japanese economy was not only backward, when compared with that of the chief Western nations, but the foundation for a new era of expansion seemed to be ill prepared. In the space of some sixty years, however, Japan had been transformed into a modern industrial state, equipped with all resources of applied science and technology and capable of producing efficiently most types of manufactured products. She had established adequate systems of finance and communications. Her mercantile marine was the third greatest in the world. Her overseas' trade was large and was still growing rapidly; in its composition it was in most respects typical of that of a modern industrial state. In the nineteen-thirties Japan was conducting with success large-scale undertakings beyond her shores, and she was becoming an important investor in overseas' enterprise. She possessed an efficient bureaucracy and a skilful and experienced class of entrepreneurs, technicians and managers. Her workers rivalled in skill those of far older industrial countries. Since the beginning of the Meiji era her population had doubled itself but meanwhile the standard of living of her people had risen. Political changes had accompanied the economic expansion. Japan had made herself into a great military and naval power, and since 1894 she had pursued with success a policy of imperialist expansion on the continent of Asia.

Japan's economic development may be attributed to such factors

as the sense of national unity being as it was the product of her geographical position, of linguistic uniformity and of her long history; the centralised form of government; the progressiveness of the new rulers who were not demarcated from the rest of the population; government aid to industry for strategic reasons and national power; technical inheritance; and the large foreign demand for new silk owing to the great expansion of the American market. None the less important, however, was the role of the foreigner in the economic expansion of that country. (1)

In promoting Japan's economic life, the role of the foreigner was not confined to technical assistance and the transmission and appropriation of Western production techniques. Western influence brought about along with the foreigner made itself felt in other directions. The latter decades of the nineteenth century witnessed the rise in Japan of new industries and new forms of organisation rather than the persistence of the old. These innovations were in part the result of a government policy of creating foreign-style industries such as were considered necessary for national power, but they were in part the result of the appearance of new wants among the Japanese public being as they were the reflection of Western influence.

It then follows that, in order to set in motion a process of economic development, there should emerge two types of men who are

(1) C.f. G.C. Allen, *op.cit.*, p. 154.

indeed the agents of progress: new men at home forming the new ruling class, and new men from abroad carrying with them new ideas and techniques. With these two types of men, the social structure is bound to undergo substantial changes in favour of progress and expansion of economic life.

abroad in the process of economic development, it is now time to enquire into what it is that activates economic stagnation into economic progress. Social institutions, as, for instance, the caste, the ruling class, religion and the family, may be inimical to progress: if such is so, the remedy is of course the overthrow of their overlordship. Men outside the grasp of the ruling class might be expected to bring into being a new social structure which would be more favourable to progress.

But there are two first of all access to political power in order to achieve such a fundamental reform. This might involve a change in the balance of power in the country. Since a new power is to be set up, it is necessary to study the concept of the state and its institutions which may sometimes place difficult obstacles in the way of economic development.

In this regard, it is necessary to study the concept of the state and its institutions which may sometimes place difficult obstacles in the way of economic development.

CHAPTER 11.

THE STATE AND THE RULING CLASS.

Having considered the important part to be played by new men at home and foreigners from abroad in the process of economic development, it is now time to enquire into what it is that activates economic stagnation into economic progress. Social institutions, as, for instance, the state, the ruling class, religion and the family, may be inimical to progress; if that is so, the remedy is of course nothing short of their overthrow. New men outside the circle of the old ruling class should get together to bring this about and establish new social institutions which would be much more favourable to progress.

But these new men must first of all ascend to political power in order to achieve such a fundamental social reform. This being granted, it is well in order to proceed with a socio-economic study of the concept of the state and other social institutions which may sometimes place difficult obstacles in the way of economic development in most under-developed societies.

1. THE CONCEPT OF THE STATE.

As far as the state as a social institution is concerned, the crucial point is indeed the extent to which it is organised. In this respect, history suggests that it is almost inconceivable

to overthrow the existing social regime if the State is strong and highly centralised. This was indeed the case with the Russian State during the eighteenth and nineteenth centuries. While economic progress was proceeding vigorously and rapidly throughout Europe during that period, the Russian State was meanwhile so strong and highly organised that it was able to suppress any progressive elements hostile to the existing form of government. If, on the contrary, the political framework in the community is weak and corrupt, with feudalism dominant and local authorities powerful, it is more likely to be amenable to progress. For such a political structure can be easily destroyed by the creative minority. The new political upheaval in Egypt is a recent and striking case in point.

Assuming now that a new political structure has been established, ousting from power the old ruling class of priests, or landlords, or capitalists, what is now required under the new regime? Again what is really required is a strong national state. Historical evidence goes a long way to substantiate this proposition. Never in its history did China achieve a strong, highly organised state; hence it was scarcely possible to create progress in such a political structure. Brazil, too, has shown so little economic progress throughout the last century, in spite of the fact that she had adequate natural resources comparable to those of many advanced countries. The main reason for this relative under-development seems to be that her geographical

situation has hindered the creation of a powerful national state. Again there is a striking contrast historically between the achievements in the economic sphere of England and Germany. England became highly organised and centralised from the fifteenth century onwards, and within this political framework there has since been created an atmosphere favourable to progress; economic expansion was all the more vigorous and rapid on all fronts. The fact that Germany was disintegrated explains the paradox of the relatively under-developed German economy as late as the nineteenth century, even though productive resources were by no means inadequate. When at long last the country was unified under the leadership of Bismark, conditions then became favourable to economic progress.

Thus, a major pre-requisite of economic development in under-developed societies is an evolution in the form of government. This would only mean the overthrow of the old ruling class that is inimical to progress, and the establishment of a new progressive class that should have one end in view: the achievement and maintenance of national unity and integrity as well as the initiation and promotion of economic development.

Such a conclusion obviously demonstrates the extent to which the concept of the ruling class is all the more significant for any systematic study of the causes of stagnation or progress in the under-developed society. It is worth while therefore to push our analysis one step further and discuss with more clarity and

exactitude when a ruling class as such is conducive or not conducive to progress.

2. THE CONCEPT OF THE RULING CLASS.

It may safely be said that the forces making for readjustment of institutions are, in the last analysis, almost entirely of an economic nature. The group is made up of individuals and the group's life is the life of the individuals, and the group's accepted scheme of life is the consensus of views held by them as to what is right, good, expedient and beautiful in the way of human life. In the alteration of conditions of life that comes of the changed method of dealing with environment, the outcome is not an equal change in the facility of life throughout the group. The altered conditions may increase the facility of life for the group as a whole; but usually the redistribution results in a decrease of facility or fullness of life for some members. For instance, advances in technical methods or changes in population or industrial organisation, will require some members to change their habits of life if they are to enter with facility into the altered industrial methods, and in so doing they will be unable to live up to the received notions as to what are the right and beautiful ways of life.

Anyone who is required to change his habits of life will feel the discrepancy between the methods of life required of him by the

newly arisen exigencies and the traditional scheme of life to which he is accustomed. It is the individuals placed in this position who have the incentive to reconstruct the received scheme of life and are most readily persuaded to accept new standards. It is through the need to win the means of livelihood that men are placed in such a position. The pressure exerted by the environment upon the group, making for the readjustment of its scheme of life, impinges upon the members of the group in the form of pecuniary exigencies. The forces are therefore chiefly economic, i.e. these forces take the form of pecuniary pressure.

The ruling leisure class, however, is sheltered from the stress of these economic pressures and exigencies of struggle for means of subsistence; or at least they are less exacting for this class than for any other. As a result of this privileged position, it is expected to find the leisure class one of the least responsive to demands which a new situation makes for the further readjustment of institutions. (1)

That the ruling leisure class is the conservative class in Eastern communities is a truth which can be recognised on the following grounds. First, the exigencies of the general economic situation do not directly impinge upon the members of that class. They are not required, under the penalty of forfeiture, to change

(1) C.f. Thorstein Veblen, *The Theory Of The Leisure Class, An Economic Study of Institutions*, Chapter VIII, pp. 188-211.

their habits of life and their theoretical views of the external world to suit the demands of an altered industrial technique, since they are not in the full sense an organic part of the industrial community. These exigencies, therefore, do not produce, in the members of this class, that degree of uneasiness with the existing order which alone can lead any body to give up views and methods of life already habitual to them. The office of the leisure class in the social evolution of Oriental societies is to retard the movement and conserve what is obsolescent.

Moreover, conservatism, as being an upper class characteristic, has acquired a certain honorific value. The fact that the usages, actions and views of this class acquire the character of a prescriptive canon of conduct for the rest of the community gives added weight and power to the conservative influence of that class. It makes it incumbent on all reputable people to follow their lead, so that by virtue of its high position the wealthy class comes to exert a retarding influence upon the social development far in excess of that which the simple numerical strength of the class would assign it. The prescriptive example acts to stiffen resistance of all other classes against innovation and to fix men's affections towards the good institutions handed down from earlier generations.

But the leisure class has also a material interest in leaving things as they are, i.e. in preserving the status quo. Under the circumstances prevailing at any given time, this class is in a

privileged position and any departure from the existing order may be expected to work to the detriment of the class rather than the reverse. This interested motive comes in to supplement the strong instinctive bias of that class, and so to render it more conservative than it otherwise would be.

Nevertheless, the arguments in favour of the ruling class are no less impressive. It is sometimes argued that if a society were created on an entirely egalitarian basis all its members would be so poor and so preoccupied with their means of subsistence that they could hardly have enough leisure time to be devoted to social progress. If, however, the society keeps a minority who, by virtue of their social standing, will have enough leisure time to devote themselves to government, art, scholarship, sport, music and all other kindred activities, it actually is preserving a valuable asset in terms of human ingenuity, skill and statesmanship. Civilisation can hardly be maintained and good government achieved but for the upkeep of the energies and potentialities of the members of the leisure class. No progress can be expected unless there is a small ruling class who alone can preserve the dignity, values, traditions and all items of civilisation in the society. Thus every society must have a ruling class, a small number of non-wage earners, unproductive workers who rule and govern and live, not on the fruits of their own labour, but on the produce of the rest of the society.

Furthermore, there may be a grain of truth in the view so often expressed by the spokesmen of the conservative elements, that, without consistent resistance to innovation on the part of the conservative leisure class, social innovation and experiment would hurry the community into untenable and intolerable situations, the only possible result of which would be discontent and disastrous reaction. "What is, is right" is the conservative view opposed to the more liberal view that "what is, is wrong". However, it is not that the institutions of to-day are wholly wrong for the purpose of life of to-day, but they are always, and in the nature of things, wrong to some extent. The institution of a leisure class, by force of class interest and instinct and by prescriptive example, makes for the perpetuation of the existing maladjustment of institutions, and even favours a reversion to somewhat more archaic scheme of life.

It remains true, however, that institutions change and develop as time goes on. There is a cumulative growth of customs and habits of thought, a selective adaptation of conventions and methods of life. Something therefore should be said of the office of the leisure class in guiding this growth as well as in retarding it, but only in regard to those institutions that are primarily of an economic character. The economic structure can be said to be composed of two main categories of institutions: institutions of acquisition and institutions of production. The latter category is not often recognised as institutions, for they do not concern the ruling class, and therefore

are seldom the subject of legislation or deliberate convention. When they do receive attention, they are commonly approached from the business side. The relation of the leisure class, is held to be a pecuniary one which manifests itself in adopting pecuniary institutions, giving it the best effect for the acquisition of private gain. This relationship explains the consistent trend in the leisure class guidance of institutional growth, answering to pecuniary ends and shaping the leisure class economic life. Its effects are seen in those enactments and conventions that make for security of property, enforcement of contract, facility of pecuniary transactions and vested interests, as, for instance, changes affecting limited liability, banking and currency, trusts and pools etc.

"The community's institutional furniture of this kind" says Veblen "is of immediate consequence only to the propertied class, and in proportion as they are propertied; that is to say, in proportion as they are to be ranked with the leisure class. But indirectly these conventions of business life are of the gravest consequence for the industrial process and for the life of the community. And in guiding the institutional growth in this respect, the pecuniary classes, therefore, serve a purpose of the most serious importance to the community, not only in the conservation of the accepted social scheme, but also in shaping the industrial process proper."⁽¹⁾

(1) Ibid., p.210.

But even if the ruling leisure class as an institution is justifiably established in the society, a further issue may still arise. In what way are the members of this class maintained and recruited? The ruling class could be maintained either out of taxation, as was the case in Russia, or by endowments as in the feudal states. Members of the class can be recruited afresh in each generation by test, or can be recruited by hereditary principles. But if the former practice were adopted, what test would be applied? There seems practically no test to apply. Besides, the members of the class cannot be recruited every generation, for it takes at least two generations to do the training for the job, to make a gentleman capable of assuming the office of government. We are then left with the other alternative, i.e. recruitment by hereditary principles, but this should eventually lead to decay. Probably in the second, and most certainly in the third and fourth generations, the legacy of civilisation and material progress is handed over to the weak inheritors, and all that was built up in previous periods fall to pieces. The fact that the hereditary system is a weak one is well recognised and acted upon in the real world. Turkey, for instance, built up a vast empire which lasted for almost three centuries by recruiting afresh each generation new members of the ruling class from Christian boys who were brought up to be the rulers of the Empire. When the system was eroded by the Sultan, allowing the Janissaries to marry and bring up their own children, this source

of fresh recruitment dried up and resort was had to the hereditary principle. But most societies disintegrate when this principle dominates their life, and this is precisely what Turkey had experienced when the Empire went into decay.

Hereditary principles therefore have to be abolished if a society is to be built up anew. Rapid progress can only be achieved in 'open' societies, so to speak, in societies which have both vertical and horizontal mobility, and whose members regardless of caste, creed, or colour can rise from the bottom to the top of the social ladder. Problems arise when members of the ruling class establish a social system which may deny to enterprisers the resources they need for organising new units of production. Thus it may not be possible to recruit labour because it is tied to the soil by law, or because caste restrictions prevent labour from moving to new occupations. Or land may be concentrated in the hands of a small number of persons who are unwilling, often for reasons of political prestige, to sell it to persons outside their group. Or the banking system may discriminate against borrowers of a particular race or creed. In other words, horizontal mobility of resources is, like vertical social mobility, a pre-condition of economic progress. But both types of mobility, although socially desirable, are probably retarded by the deliberate action of the ruling leisure class.

CHAPTER 12.

RELIGION AND ECONOMICS

1. ECONOMIC ETHICS IN CHRISTIAN PHILOSOPHY

Thomas Aquinas was said to have taken infinite pains and ingenuity in an attempt to weld the teachings of the Bible and of Aristotle into a harmonious body of thought. One result of his attempt was the celebrated classification of laws into eternal, natural, human and divine. The first is the controlling plan of the universe as conceived by God; that part of it which can be grasped by man and which enables him to distinguish good and evil is natural law; while human or customary law consists of the enactment of earthly powers. Divine law is that part of the eternal law revealed in the holy writings. Human or customary law should be based upon natural law. It falls into two parts: civil law (Roman) and Canon law (Church). Canon law was coordinated and given a systematic form about the middle of the twelfth century. It was drawn from a mass of ecclesiastical legislation and decision, thus containing elements of Christian doctrine, Aristotelian philosophy, and Roman law; and it expressed the judgment of orthodox churchmen concerning human relations, and so contained economic ideas.

The tendency of scholasticism was on the whole opposed both to individualism and to the emphasis of the human personality as the basis for economic decisions. It tended to subordinate the

individual to the institution and to consider man as subject to "natural" laws. Thus, on the one hand, it tended to limit that reference to individual choices which was to become the basis of economic science; while, on the other, it kept alive and emphasised the concept of social uniformities and the dominance of abstract "laws" which later contributed to the idea of that science. But scholasticism was neither Christianity nor the Church, but only part of each with an admixture of the philosophy of Aristotle. It was the system of thought which came to be dominant during medieval times; it cannot be called a science, for it did not seek to explain phenomena so much as to apply certain absolute rules of conduct to existing conditions. It was only the scholarship of the Middle Ages.

Apart from the Roman component, Christianity and the Church may be considered next as perhaps the chief factors in determining medieval thought. It should be borne in mind, however, that Christianity as a religion is quite distinct from the various institutions or churches which profess it. The following are the principles of Christian doctrine which have any direct economic significance. Christianity taught a brotherhood extending beyond community or nation, embracing all classes and races. In accordance with this spirit, the Church taught the natural equality of rights among men. On that score, slavery was condemned, wholly or in part, the least radical teaching being that slaves should be freed when Christianised. Closely

connected with the doctrine of brotherhood and equal rights was the idea of a natural community of property; originally, and according to the law of nature, men owned all goods in common. Besides, one of Christianity's teachings was that concerning the dignity of labour; another was the virtue of charity and almsgiving. Finally Christianity was a force for purifying and perpetuating the family and the family life.

These principles of Christianity were considerably modified or given a special meaning in their practical application by the Church. To mention but an instance or two: the "natural" law of equality was admitted to be modified on grounds of expediency so as to permit inequality both in property and in status. The idea of brotherhood was reconciled with inequality in wealth by teaching that charity is a duty, and by preaching that the rich should regard themselves as trustees for their brother men. At the same time, it must be noted that charity was too commonly regarded as an end, as a pious thing, rather than as a means for benefiting society or the poor. So, too, with manual labour: it was regarded rather as a form of discipline for the attainment of salvation than as a means of producing wealth. Pride was not to be taken in the craft, and the main interest was not to be in the product. As a rule, the general economic environment was not favourable to the complete advancement from slavery, and the Church made room for it on grounds of expediency. Serfdom could scarcely have disappeared in towns by the tenth century, while in

agriculture serfdom lingered on into the nineteenth century. Still, there was the tendency towards freedom.

Prior to the thirteenth century, the Church fathers concerned themselves but little about economic matters. On the one hand, a very simple independent domestic economy prevailed; on the other, purely religious ideas were in control. Consequently, one finds little but moral dissertations concerning the evils of luxury and the like. Among the most noteworthy economic ideas were those concerning the desirability of wealth, values, and the relative merits of different forms of industry. In these there is little new. Agriculture was praised; manufacture did not displease God; but trade could not be pleasing to the Deity. Material wealth was dangerous to spiritual welfare, though it was permissible to the laity if used for the good of their fellow men. As to value, the recognition of labour was preparing the way for a cost theory based on the labour element. The general notion appears to have been that value is absolute and independent of price. Accordingly, exchanges were looked upon as just or unjust in proportion to the equality of the absolute values, and usury was forbidden to churchmen on the grounds that in the taking of interest a greater value would be exacted than that given, which would result in injustice to the borrower. (1)

But as early as the eleventh century there were some indications of social progress. With the growth of monasteries,

(1) C.f. L.H. Haney, History of Economic Thought, p.95.

towns, handicraft, and commerce, and the increasing use of money, new phenomena were presented; while in the twelfth century the first Latin translation of Aristotle's Politics found its way into Western Europe. This fact marks a new epoch in medieval thought.

Theses on the subject have drawn attention to the clash between religion and economic development. Medieval religion rejects the idea of gain in commerce, finance, and industry. A capitalist system requires a free market for capital, but medieval theologians showed much concern over the question of gain and usury. Orthodox churchmen used the term 'usury' to cover what we designate as interest; and, in a broad sense, to include any excess over and above the 'just' price. At first (325 A.D.) usury was forbidden to the clergy only, but before the close of the twelfth century the prohibition was extended to the laity. As late as 1311 it was declared absolutely illegal. The broad simple ground for this action was the belief that to take interest for a loan of money was like charging more than the just price. However, the development of industry and exchange brought forth a gradual modification of the doctrine of usury or value of money. Aquinas and his brother scholastics recognised that where, for example, a loss was incurred by a loan, or a profit was missed, a corresponding sum might be demanded of the borrower. A buyer on credit was not prohibited from paying more than the cash price. Discounts were allowed on bills of exchange, and money combined with labour in partnership was called productive. Jews and

Lombards, being damned anyway, were permitted to take usury. And, in the fifteenth century, banking houses were associated with financial operations, and thus it became difficult for the Church to frown upon interest on bank deposits.⁽¹⁾

The medieval idea of usury could not have long existed in a money economy. The social organisation, with which the biblical writers, Aristotle and the schoolmen alike were associated, was non-capitalist and largely self-sufficient. They were not exchange economies, and the political counterpart of this industrial condition was a predominance of clan or family feeling, a feeling which appears in the gild and even in the medieval municipality. This explains to a large extent the general condemnation of interest-taking. Loans at interest generally involve a rather abstract or impersonal relation between the parties, such as became common with the establishment of a money economy. Even to-day, the purely business relation is apt to become unsatisfactory when existing among relatives or persons belonging to the same social organisation, and the condemnation of usury was natural when most of a man's dealings were with such persons.

If, in England the Reformation was a revolution, it was a revolution which left almost intact both the lower ranges of ecclesiastical organisation and the traditional scheme of social thought. Where questions of social ethics were concerned, the religious thought of the age was not less conservative than its

(1) C.f. Henri Pirenne, *Economic And Social History of Medieval Europe*, Chapter IV, Sec. IV, *Credit And The Traffic In Money*, pp.118-141.

ecclesiastical organisation. Both in their view of religion as embracing all sides of life, and in their theory of the particular social obligations which religion involved, the most representative thinkers of the Church of England had no intention of breaking with traditional doctrines. By the sixteenth century, the law of 'nature' had been invoked by medieval thinkers as a moral restraint upon economic self-interest; by the seventeenth century a significant revolution in thought had taken place. 'Nature' had come to mean, not divine ordinance, but human appetites, and natural rights were invoked by the individualism of the age as a reason why self-interest should be given free play. Prompted by these intellectual changes, the policy towards interest-taking began to be reversed, and by the middle of the sixteenth century the law prohibiting all interest was repealed in England, and the exaction of interest ceased to be a criminal offence, provided that the rate did not exceed a certain moderate percentage. It was therefore established that the law should not impose on business a utopian morality. The sixteenth and seventeenth centuries saw the expansion of finance and international trade, and the need arose for the reconsideration of the religious doctrine which had tried to moralise economic relations, by treating every transaction as a case of personal conduct, involving personal responsibility. The following is an illustrious quotation from R.H. Tawney on the economic side of religion:

"In an age of impersonal finance, world markets and a

capitalist organisation of industry, its traditional social doctrines had no specific terms to offer; and were merely repeated when, in order to be effective, they should have been thought out again from the beginning and reformulated in new and living terms. It had endeavoured to protect the peasant and the craftsman against the oppression of the money-lender and the monopolist. Faced with the problems of a wage-earning proletariat, it could do no more than repeat with meaningless reiteration its traditional lore as to the duties of master to servant and servant to master. It had insisted that all men were brothers. But it did not point out that, as a result of the new economic imperialism which was beginning to develop in the seventeenth century, the brethren of the English merchant were the Africans whom he kidnapped for slavery in America, or the American Indians whom he stripped of their lands, or the Indian craftsman from whom he bought muslins and silks at starvation prices. Religion had not yet learned to console itself, faced with the practical difficulty of applying its moral principles, by clasping the comfortable formula that, in the transactions of economic life, no moral principles exist. But, for the problems involved in the association of men for economic purposes on the grand scale which was to be increasingly the rule in the future, the social doctrines advanced from the pulpit offered, in their traditional form, little guidance. Their practical ineffectiveness prepared the way for their theoretical abandonment."(1)

(1) R.H. Tawney, Religion And The Rise of Capitalism, London, p.184.

This defect was fundamental. It made itself felt in countries where there was no Reformation, no Puritan movement, no common law jealous of its rights and eager to prune ecclesiastical pretensions. But in England there were all three, and from the beginning of the last quarter of the sixteenth century ecclesiastical authorities who attempted to enforce traditional morality had to reckon with a temper which denied their right to exercise any jurisdiction at all, above all any jurisdiction interfering with economic matters. Then came the Long Parliament, the fierce denunciations in both Houses of the interference of the clergy in civil affairs, and the legislation abolishing the Court of High Commission, depriving the ordinary ecclesiastical courts of penal jurisdiction. The change had begun before the Civil War and was completed with the Restoration.

2. ECONOMIC ETHICS IN ISLAMIC PHILOSOPHY

But Islam, as well as medieval Christianity, has revolted against interest-taking. Whereas the West under the pressure of economic expansion has come to justify the taking of interest, and in fact distinguishes in practice between common usury and the results of productive investment of capital, Islam still carries the moral law openly through into the commercial sphere. The condemnation of the Koran of "the devourer of usury" is regarded in many Moslem circles as being as valid to-day as it was 1300 years ago. The word used in the Koran for interest or usury is 'riba', meaning increase in anything or the additional amount

which a debtor pays to a creditor. According to Moslem jurists, 'riba' is the extortion of wealth without legal or lawful consideration; and the taker of 'riba', its giver, the scribe of the deed, and the witness to it, have been pronounced by the Prophet to be alike cursed in their sin.

It should be borne in mind, however, that Islam does not forbid the giving of credit in general. The essence of its objection to the taking of interest is that the creditor receives an increment on his loan and that this increment is a fixed periodic sum. If, on the other hand, one puts one's money into a business as a partner and takes a profit by sharing in the risks of undertaking this is legitimate in Islamic theory. For here the increment on one's money is uncertain, and it is the reward for uncertainty-bearing. According to a Moslem scholar, "the creditor's deriving a profit from every investment in business is uncertain whereas this additional amount (riba) from the debtor to the creditor is certain".⁽¹⁾

True, the medieval churchmen and the Moslem jurists built on different religious foundations. But the same basic social and economic conditions apply in both the medieval Christian and modern Islamic societies. Both societies have an essentially peasant basis to their social structure and trade rather than industry as their major outlet for economic enterprise. What Tawney says of the medieval West, that the doctrine of interest

(1) G.A.I. Qureshi, *Islam And The Rate of Interest*, Lahore, 1945, p.52.

received its character in an age in which most loans were not part of a credit system but an exceptional expedient, seems to apply in large measure to the contemporary East as well. The prohibition of interest, then, is not just the result of an arbitrary moral attitude about the use of money. It is linked with a type of society in which the use of money in certain ways is apt to result in clearly perceptible personal hardship, and in the drying up of that fount of compassion which should remain fresh in every human being.

In Modern Islam, as in medieval Christendom, these doctrines have not passed without either challenge or evasion. The Christian story is well-known. In Islam there are two parallel movements, both responsive to the economic situation, but in different ways. One is that of plain side-stepping of the Prophet's injunctions. The writer knows of cases where lenders of money secretly received a fixed increment on their loans. Or, in order to be able to defend it before the courts, if necessary, they lent a smaller sum than was written down for repayment on the document agreed to by the borrower. The courts, which disallow any case brought where there was a bargain for payment of interest, would have no evidence that less than the agreed sum for repayment had in fact been handed over. On the other hand, Moslem modernists argue for a more refined interpretation of the Prophet's views; some defend the taking of interest on the grounds that what the Prophet really disallowed was 'usury'

and not the moderate rates of interest. This view is refuted by the more orthodox jurists who argue that, even though usury is commonly regarded as an exorbitant rate of interest, ideas as to exorbitance vary greatly at different times; hence there is no essential difference between the two concepts. Another view is that simple interest is allowed, but not compound interest. But this view again is regarded by most Moslem jurists as very specious. Some modern Moslems of the educated class regard even ordinary interest on bank deposits, as illegitimate for them. Although many Moslems do in fact accept the addition of interest to their bank deposits, this is regarded by orthodox jurists as a "personal weakness" analogous to that of not saying one's prayers regularly at the prescribed times. A strictly orthodox view of the role of banks in an Islamic State is that they pay no interest to depositors and charge no interest to their clients. In other words, they should treat all deposits as Western banks treat current accounts, and depositors should use them only for security and not for profit.

The prohibition on 'riba' was also extended by the Prophet to such transactions of exchange whereby quantities of gold, silver, wheat, barley, dates, and salt are exchanged for more or less of the same kind of commodity. Trade in general is encouraged, but this prohibition puts a bar on concealed interest-taking and direct dealing in futures. But here again there is a difference of opinion among the learned men of Islam. Some wish to extend this

prohibition in modern times to all commodities. Others, holding to the letter of the law, argue that one may not reason by analogy, and that it is only the six commodities specifically mentioned by the Prophet which are so affected.

A sophisticated view of the orthodox Moslem position has recently been expressed by Mr. G.A.I. Qureshi, a Moslem scholar and an academic economist, in a published work entitled 'Islam and the Rate of Interest'. His thesis is that many of the ills of the capitalist society are mainly due to interest and that Islam has indeed made a contribution to the solution of world ills by the definite prohibition of interest. He quotes Western historical precedents in support of his contention. Aristotle's comparison of money to a barren hen which laid no eggs is cited, likewise the medieval objections to interest. To him, as perhaps to others, the age of faith has given place to the age of science, but not necessarily to that of reason. He defends his orthodox view by arguing that Western economists are not agreed on the nature and theory of interest, that Keynes and others have regarded the rate of interest as a highly conventional phenomenon, that the rate of interest in Western countries is progressively becoming lower. It is thus theoretically possible and practically by no means out of the question that the minimum rate of interest may be a zero rate. His final conclusion is that what Islam has forbidden on religious grounds should be abandoned on economic grounds. The certainty, regular accumulation, and lack of

expenditure of effort characteristic of interest-taking militate socially and economically against it. To him, as to most Moslems, the proper method of using capital is the partnership system, in which capital co-operates with labour, and gets a profit on the joint result. This profit in turn should be allocated in an agreed proportion of the joint product, and not as fixed percentage of the principal sum invested. This is the Moslem profit-sharing enterprise. Islam has thus not illegalised all transactions which produce income without labour. In fact, in addition to the profits of co-partnership, it allows rent from houses and agricultural land. What it objects to is a situation where only one party bears sacrifice or risk and the other remains immune or practically so. ⁽¹⁾

However, the clash between religion and economic development is not only confined to the religious ban on the use of certain forms of capital. Religion as an institution is sometimes held to be a deterrent to economic development in some other ways. It may discourage the experimentation of science by prescribing the way in which things should be done in the economic field. In the extreme cases, this can be observed in primitive societies where the method of cultivation of the soil is dictated by religious rites. Besides, religion can be a menace to progress if religious chiefs throw their weight on the side of a reactionary ruling class, for, as is well-known, control over religion in all Eastern

(1) C.f. Raymond Firth, *Elements of Social Organisation*, London, 1951. p.169.

communities denotes control over the minds of the people. Again, if religion were the principal vocation in a society, a major part of the community's resources would probably be devoted to religious purposes. This is exemplified by ancient Egypt where the temples played a great part in shaping the conditions of life, and by Tibet where religious exercise dominates the minds of the masses. Overmuch indulgence in religion becomes an obstacle to progress in the same way as overmuch indulgence in politics in a subjugated country diverts people's energy from the task of promoting their national economy to the struggle for their political independence.

The morale of the historical evolution of Christian and Islamic religious thought, as described above, is that, for economic progress, religion as a social institution need not be thrown overboard. Religion may be a temporary handicap, but when this is recognised by theologians, all they have to do is to set out to work a new theology in such wise that it can easily fit in with changing economic conditions.

In point of fact, almost all religions seem to follow social changes. In the Christian West this sociological sequence was eventually realised seventeen centuries after the beginning of the Christian era. There is no reason why this should not be true of the Islamic East. There is no reason why the religious code of human behaviour should not be so adapted to social changes as to allow complete economic freedom in Eastern societies where religious ideas have always been in firm control.

CHAPTER 13.

THE ECONOMIC SIGNIFICANCE OF THE FAMILY.

1. THE FAMILY AS A SOCIAL UNIT.

It is now time to consider those social units through which organised activities are being carried out. By far the most important social unit is the family.

Our starting point may be the individual man or woman, making choices as to how much of his or her labour shall be devoted to one occupation or another, or shall be reserved for enjoyment in leisure, or as to how much of his resources shall be devoted to immediate consumption of goods and services, or to saving for the sake of enjoyment in the future. No matter how definite the social setting of that individual may be, he or she may be skilful or clumsy in managing this economic problem. But these individual differences tend to cancel out. Society as a functioning whole requires its members to work within its frame. Hence we arrive next at the family as the most intimate and pervading unit. At once great differences become visible between the Oriental family and that with which we are familiar in the Western world.

The first major difference is that in the West we usually think of the family as a unit within which the housewife usually decides as to the disposal of her available resources, brings her children to adult status, teaches them the traditions of life and

its disciplines, inculcates into their minds the social values which were handed over to her as a valuable heritage of the past, and finally launches them into the world where they may found other families.

The Oriental family, too, has its primary function of raising children to adulthood, but it does much more. It is also the unit within which economic resources are brought into existence. It is the unit within which men and women find their life's employment. Within its circle the most fundamental economic choices are made, while when it co-operates with other families it remains very much the key organisation. It is within the circle of the family that grain is grown, that flocks are tended, that the proceeds are allocated to various members and to various uses. It is in co-operation between families that such great manipulations of resources as the bride-price takes place, that the family of a chief is maintained by others, that families connected by marriage maintain economic intercourse with each other. So all-pervading is the activity of the family in Oriental society. It is in dealing with property, land tenure, agricultural systems, inheritance and similar topics that many of the economic aspects of family life in such a society can be readily seen.

Another major difference is that, whereas a Western family usually provides a stimulus to work and saving, this is not necessarily the case with an Eastern family. It is doubtful, indeed, that a family system will provide incentives to work outside a

Western community. The Eastern family is related to the problem of economic progress by what the anthropologist calls the 'extended family system'. By this term is meant that people recognise not only their parents but the whole pedigree of the family. When an Englishman talks or writes about the family, what he has in mind is the unit composed of father, mother and children. It is in these terms that sociologists in England think when they discuss the size of the English family. In an Eastern community, however, the family normally consists of these members together with a score of uncles and aunts, nephews, nieces and distant relatives.

In this way, there exists what may be called 'family communism', the important function of which is to carry out some sort of social security scheme. Any member of the family can call upon his near or distant relatives for financial help, if the need arises. But these family obligations put a heavy conventional tax on those more prosperous members of the family who are committed, by virtue of family ties, to support the less fortunate members, e.g. kinship in India and Africa. It is likely that, if family ties are strong, a man will feel a greater responsibility to get on in the world for the sake of his 'extended' family. It is more likely, however, that the more prosperous member will be reluctant to work harder so long as a significant part of the fruits of increased work is earmarked for the maintenance of other needy members. This conventional family-tax is indeed a serious handicap to economic development. In Rhodesia,

for instance, the family as a social unit is intimately connected with the development of Rhodesian economy. People who possess many resources are often reluctant to work harder, since the family obligations sweep away a great part of the fruits of increased work, whereas people with inadequate resources are also reluctant to work harder so long as they can be supported by their kinsfolk.

2. THE PROPERTY INSTITUTION.

The next step in this study is to show in what ways social groups in any society exercise that power to use economic goods, which is known as ownership. Like all peoples, the people of a primitive society have effective distinction between various types of economic goods. It is as true of the primitive people as of any other people that Nature supplies them with extremely few goods ready for immediate use. They proceed to apply their personal powers to certain materials provided by Nature in order to fashion them into commodities capable of technical manipulation under the guidance of economic management. It is thus that the material of the primary environment comes to be changed into that secondary environment essential to human culture, and of which the main characteristics are that, instead of being an undifferentiated mass of resources, it is a collection of goods susceptible to ownership and to consequent economic management. Further, these

goods are limited in relation to effective human wants so that, at any level of culture, they are certain to be the subject of defined ownership, since without this their economic management would be impossible.

The extent to which the primitive people or any other people convert the primary environment into a secondary environment of manageable goods is conditioned by such a non-economic factor as the state of the people's knowledge, and by another factor, more relevant to economics, i.e. the felt pressure of their aggregate wants. These two factors determine the extent to which the natural resources remain latent or are turned into manageable commodities. The felt wants, however, are the ultimate determinant for, should they increase, it is highly probable that the people would succeed in increasing their knowledge and their technical capacity to exploit the resources of Nature.

The felt wants may be taken as determining the economic choice involved in the expenditure of a greater or a smaller amount of labour. Should these wants remain fixed at a certain level, they may be satisfied by the devotion of a certain proportion of the people's time and energy to the manipulation of the raw natural resources. In any given community there appears to be a tendency for the aggregate of human wants to change only within limits, for it is clear that violent fluctuations would tend to disrupt the society. It further appears that this aggregate of felt wants, while it can vary as between individuals,

yet has a certain uniformity within any effective social group with economic foundations, for should one individual expand his desires and make a consequent readjustment as between his leisure and his working time, he is seldom able to express this change entirely on his own initiative. It is in such a matter as this that the effectiveness of groups as economic subjects can be seen in a primitive society. Should, for instance, a younger member of the household be much more willing to work than the rest of the household within which he must operate, he will be held back by the rest so that his preference will become only one of the pulls within the economic subject. Thus the conversion of part of the primary environment into disposable goods is carried out by the people, operating through their social organisation. But this organisation is not only a kind of technical instrument for the exploitation of resources, but also the group of effective economic subjects which carry out complete economic management.

The resources of the primary environment having been converted into economic goods, they take on the character of property. It is from the various ways in which the property relation functions among the members of a primitive peasant community that the true nature of the economic subject can be readily seen. The sociological fact of property, enforced by custom or law, is invariably at the root of economic disposal of resources, and indeed had its necessity in this economic disposal. Nothing is more important to the integration of a culture than the economic utilisation of its scarce resources, and it will be found everywhere

that this is reflected in very clear formulation of the principle of ownership. In an agrarian society, however, the most important item of property is of course land, and the conditions of land ownership are a factor of primary importance.

3. LAND OWNERSHIP.

In the Middle East, and especially in the Moslem World, conditions of land ownership have been shaped by the heritage of history. If the sociologist wishes to understand the complicated land questions to be met with in the countries of to-day, he must pay attention to the historical background going back to the Middle Ages, if not to late Antiquity. All historians seem to agree that conditions of land ownership are a factor of central importance for the whole course of ancient history. Further, the distribution of land forms not only the foundation of every state system, but also of every pre-state community and social group. Real or alleged injustice in the distribution of land was always the primitive motive for serious social warfare in ancient times. Division of landed estates was the ancient battle-cry which excited revolutions and wars in the Greek cities.

In the matter of land ownership, the Oriental countries, ruled as they were to a great extent by hierarchical constitutions, differed quite appreciably in ancient times from the countries of Southern Europe. Whereas in the latter private ownership and the

amassing of individual landed estates predominated, in the ancient State systems of the East there was a trend towards authoritarian controls and even authoritarian appropriation of landed possessions by a central body, by the head of the State, or symbolically by the Deity itself. In ancient history of the East, light is thrown on the predominance of tribal ownership as one of the most important forms of collective ownership, and evidence can be found for the existence both of collective and private landownership. Reports from Babylon show that, in 2000 B.C. and again later in 1500-1200 B.C., cases of clan ownership of land were not infrequent. The prevalence of collective ownership in Babylonia was remarkable inasmuch as from the earliest times private ownership was also known there. In Egypt, too, although we can find evidence of private ownership as early as the Middle Kingdom, all such ownership was actually an exceptional transfer of royal rights which after the triumph of the Theban Dynasty became invalid. The Pharaoh became the owner of all land in Egypt. Incidentally, the temples also played an important part in shaping the conditions of Egyptian land tenure; under Ramses III they already owned 15 per cent of the cultivable land. It is true that the temples had State lands in their possession at an earlier period, which they forfeited, but it is only at the end of the Middle Kingdom that they gradually became the determining economic factor in the country.

Apart from the amassing of big estates in few hands, it was characteristic of conditions in the Byzantine Empire that the

tendency of the ruling class was towards the grouping of the small peasants liable to pay rent and interest in tax-debt collectives as an alternative to relinquishing their property or selling the fertile parts of their holdings to the large landowners whose domains enjoyed substantial tax privileges and exemption. The collective tax-debt at that period, i.e., the obligation on the part of the landlord to pay the taxes on the adjoining properties abandoned as a result of arrears of taxes and poverty, represented a kind of collective ownership on the part of the community in respect of taxable property. The object of this institution was to make all members of the community liable for the debts of every individual member, a procedure resorted to up to quite recent times, forming a determining factor in some Oriental countries in the recreation of collective ownership.

With the conquest of the Orient by the Moslem armies a transformation in the conditions of land tenure set in which has made its effects felt on the land laws of Eastern countries up to the present day. It is true that the Arabs often refrained from interfering in the prevailing conditions of farm management. The existing peasantry was allowed to remain on its land and even encouraged to continue its normal activities. It is true, however, that the landlords, mostly of Byzantine origin, were expelled or killed; the conquerors thereby obtained free disposal of the ownership of their estates. The major part of the land thus

confiscated became the property of the Moslem community, later to be bestowed on favourites and deserving generals.

In accordance with the fundamental traditionalism of Moslem doctrine the tax categories instituted in the initial stages of the Arab conquest, Osher and Kharaj, remained in force over a long period, in spite of the political and social changes which have since continually swept over those countries. Originally, any land which paid the Osher, the tithe (single or double, i.e., 5 to 10 per cent of gross yield of land) was classed as Osher land. This applied to all property whose owners had embraced the Moslem faith at the time of the conquest or which had been distributed among the conquerors. All other land was termed Kharaj land and was liable to the payment of the tribute known as Kharaj, i.e., a tributary tax of 20 to 50 per cent, on the gross yield. Both categories of land comprised cultivated and uncultivated areas, private and public. In the course of time the original fiscal criterion of classification came to denote also a difference in conditions of tenure. Whereas originally all land apportioned to individuals, whether Osher or Kharaj land, was regarded as the private property of the owner, the right of private ownership was subsequently denied to owners of Kharaj land. The Osher estates retained the status of private property (Milk) whereas the peasants occupying Kharaj land were given only the status of hereditary tenants of the Crown on State land (Miri).

of supervision which was

The expansion of ownership rights on the part of the Crown was much facilitated in the countries under Moslem rule by the fact that the old pre-Islamic conception of the State as supreme owner found points of contact in the Moslem world of ideas, and with the Moslem conquests was transferred into the legal notions of the Arab and Turkish countries. In practice, as a result of these legal notions, the ruler or the State, as the case might be, acquired immediate possession of estates whose owners were killed. Moreover, there was the further chance on the death of the owners, who had only the status of Crown tenants, of recovering such lands for free disposal. Thus in time the extent of these State lands steadily increased, and at that time there could be distinguished various degrees of ownership. On the one hand, there was the unrestricted right of land ownership known as "Milk" which allowed the owner to dispose of his property without qualification. There was again the conception of ownership which covered "Miri" land. The owner of such property had outwardly all the status of a quasi-owner. He might sell, let, mortgage, give away or otherwise dispose of his land. Restriction, however, arose in connection with the right of inheritance. "Miri" land could not be freely bequeathed by will, but failing the recognised heirs the succession reverted to the State, although the original restriction of the right of inheritance to the sons of the testator had in time been extended. Moreover, the head of the State reserved certain rights of supervision which could not be applied to land in private

ownership, i.e. "Milk". The theory of "Miri" land was based on the assumption that the State conferred the land for cultivation and production; the recipient of land had to cultivate it, and thus was under the compulsion to remit a share to the State as tax. Besides, the validity of any transfer of "Miri" land was dependent on the nominal consent of the State.

The Ottoman land law of April 1858 which represents the first of land regulations under Ottoman rule, enumerates the following categories of land tenure, incorporating at the same time many of the existing legal traditions:

1. Milk, i.e., full right of ownership, property which like movables is in the possession of private individuals.
2. Miri, i.e., property of which the nuda proprietas belongs to the sovereign, whereas possession and extensive rights of usufruct are vested in the private owner.
3. Waqf-land belonging to endowment and pious institutions for which rights regarding ownership and usufruct are subject to important restrictions.
4. Metruka land intended for public use.
5. Mevat land for which no owner exists and which is not under cultivation.

The list however does not include one of the most remarkable forms of property in Oriental countries, namely, the Mushaa, i.e., communal land. This institution peculiar to the Orient, deserves of special treatment. Consider the case of Egypt as a typical

example of an Eastern country in which this peculiar form of communal property was predominant right up to the end of the nineteenth century. In Egypt the general Arab concepts regarding the character of land ownership up to the middle of the nineteenth century had favoured the retention of that form of land tenure in which the cultivator had but slight claims on the land, whereas the community or its symbolic representative, the head of the State, claimed the actual right of ownership. The peasant, by paying the land tax, acquired only the right to cultivate the land. Thus in Egypt, as well as in other Eastern countries, the institution of tax-farming, originally granted as a feudal privilege, was widespread; and the leading Mameluk families bequeathed it from father to son. The tax-farmers had, in addition, a claim on certain tax-free land and the right to conscript the inhabitants of their districts for gratuitous work on such land (corvee). The tax-free land itself, called Wasiyya, became the private property of the family when tax-farming was made an hereditary privilege. A further group of landowners was made up of higher officials and officers to whom land had been promised in the name of the Sultan, which was likewise exempt from taxation.

Mohamed Ali rightly directed his efforts for agrarian reform at the root of the evil, i.e., the privileged position of the large landowners. He first of all abolished those privileges which were exploited by their possessors as the most serious abuses. Only part of the taxes paid by the farmers had found its way into

the coffers of the State. After an examination of the validity of all title deeds, which served as a basis for the claims on the land entrusted to the tax-farmers for the purpose of tax collection, all such claims were declared invalid during the years 1808-1814. Those tax-farmers with a loyal past were indemnified by the grant of a life pension, the taxes from then on being collected direct by Government officials. The success of these measures lay first in the liberation of the country from the oppressive claims and privileges of the tax-farmers, so that the way was clear for further reforms. The farmers, owing to the merciless exploitation by the Mameluk families, had abandoned the cultivation of large stretches of land. In the ten years 1789-1808 alone the cultivated areas is said to have declined by two-thirds. In 1813, Mohamed Ali, who by abolishing the title deeds of the tax-farmers and by the confiscation of their private possessions (Wasiyyas), had become the owner of practically all the land, had a general land survey carried out and arranged at the same time for the distribution of the cultivated areas. The farmers received on an average between three and five acres, which were entered in the register of lands in their name. This registration did not represent any grant of ownership inasmuch as it had been expressly stated that the ownership of all the lands was reserved for the State. The peasants received only the right of usufruct, and the State reserved even the right of expropriation without compensation. Mohamed Ali did not content himself,

however, with this rearrangement of title deeds, but intervened also in the cultivation of land. He compelled the peasants under threat of punishment to bring the untilled land once more under cultivation, and established a monopoly of the trade in agrarian products. Law was passed in 1854 to the effect

The effects of these reforms were twofold. On the one hand, the development of individual ownership was encouraged in spite of the remaining restrictions on the transfer of land. On the other hand, alongside the tendency towards the individualisation of landed property belonging to the head of the State, the abuses common to this process were also rife, especially the accumulation of property in the hands of a few as a result of serious irregularities in the way of carrying out the general survey of the land. Inspectors were accessible to the bribes of the wealthy landowners many of whom remained in de facto possession of their influential position and were able to use it for the accumulation of landed property. Another factor worsening the unequal distribution of landed property was that, in order to encourage the working of uncultivated land, Mohamed Ali had earlier invested wealthy notables with land as their personal property. Such land, which was declared exempt from taxation for ten years, was distributed on condition that it was brought under the plough.

In spite of these modest reforms the farmers could not improve their lot, for the burden of taxation was not appreciably lightened in the years that followed and the frequent calling-up of the

farmers for military service and gratuitous forced labour absorbed a considerable amount of their energy. Thus the effects of these reforms were largely frittered away. In order to stimulate the interests of the farmers in the preservation of their holdings, a further law was passed in 1854 to the effect that the tenant's land which had hitherto been granted for life only, could be inherited by the next of kin. In 1858, the principle of descent was confirmed and at the same time both sexes were given equal rights in this respect. But it took a number of years before the right to acquire full ownership of their estates was guaranteed to landowners. The 1871 law, the Muqabala which granted this right, owes its existence to the financial difficulties of the Khedive Ismail. Every tenant who paid the taxes on his land for six years in advance received full right of ownership therein and in addition a permanent reduction of the land tax by 50 per cent. A considerable part of the privately owned land in Egypt passed into the hands of its present owners on the strength of this law.

This brief historical account of the development of land tenure in Egypt readily shows how detrimental is communal property to agricultural development. In most Oriental countries the Government has, therefore, in the interests of agricultural development, exercised pressure to expedite the abolition of the institution of collective ownership and the establishment of individual ownership of land. However, the tempo of this process is still slow. In some Eastern communities even to-day collective

landownership is widespread. In the Orient, therefore, the problem of collective land ownership and its adjustment to the new conditions still occupies an important, if not a central, position. Needless to say, the application of additional efforts and labour for the improvement of his holding appears to the peasant only justifiable if the fruits of such expenditure, no matter whether in the form of labour or capital, remain in his possession, and he runs no danger of forfeiting the advantages thereby attained by a change of the plots when occupied on a collective basis. Thus in societies where production is left to private enterprise, initiative will be weak unless the property institution creates incentives. Livestock cannot be improved if all pasture land must be used in common, neither can improved rotations be practised in agriculture if the enterprising farmer is not allowed to enclose his land. Private enterprise and communal property can hardly be consistent with each other and with economic progress.

4. INCIDENCE OF LAND OWNERSHIP.

From the point of view of economic progress the establishment of the institution of private property is not enough. Even if wealth is privately owned, but meanwhile concentrated in the hands of a small number of people in the society, this concentration of wealth would present handicaps to economic development. This is so because, so long as the masses of people are unable to share

sufficiently the fruits of economic progress, there is apt to be little incentive for them to exert the maximum effort. Moreover, in any society inequalities of wealth will entail inequality of opportunity to the greater part of the population; and this in turn will keep ignorant many people who would play an active part in economic development, were they given the opportunity. The great inequalities of wealth and income therefore provide one of the major economic problems of Eastern communities.

In many such communities, a major cause of income inequalities is the unequal distribution of wealth. As the greater part of the population is employed on the land and the bulk of the national income is derived from agricultural enterprise, any attempt to bring about a more equitable distribution of wealth would naturally start with agrarian structure and land tenure.

No more conclusive evidence could be found to illustrate the gravity of the distributive problem than the available data collected in respect of the distribution of land in the Middle East. Consider, for instance, the case of Egypt in 1950. Of a total number of some 2.5 million landowners, not less than 1.7 million or 70.8 per cent belong to the category of the smallest farmers who own up to one feddan (1 feddan = 1.038 acres) while their total holding is only 12.5 per cent of the cultivated area, and the average holding is less than half of a feddan. On the other hand, there are about 12,000 landowners with holdings of 50 feddans and over; these comprise one half of 1 per cent of the

total number of landowners, but they own about 37 per cent of the cultivated area. Between these extremes are the small farmers who own 1 to 5 feddans (22.8 per cent of owners, 20.2 per cent of area), and landowners with holdings ranging from 5 to 50 feddans (5.9 per cent of owners, 30.4 per cent of area). No prospects of social stability, improvement in agriculture, or of raising the standard of living of the masses can be visualised unless drastic measures, fiscal or otherwise, are taken to cope with the problem in an effective way.

"In many under-developed countries, the cultivators of the soil are exploited mercilessly by the landlord class which performs no useful social function. This class contrives to secure to itself the major part of any increase in agricultural yield, and is thus a millstone around the necks of the tenants, discouraging them from making improvements in agriculture and, in any case, leaving them too little income from which they might save to invest in the land. In such countries land reform, abolishing this landlord class, is an urgent pre-requisite of agricultural progress. Land reform is not, of course, the only pre-requisite; capital must be made available to the farmers, extension work must be organised; the size of the unit of cultivation must be reconsidered; and so on. But the land reform in these countries would be the first step necessary for releasing the productive energies of the people."⁽¹⁾

(1) United Nations Report on Measures For The Economic Development of Under-Developed Countries, May 1951, p.21.

Land reform can thus be said to serve a twofold purpose: a social purpose in the sense of bridging the gap between the two extremes of income and an economic purpose in the sense of promoting agricultural development.

required. (1)

The family farm is the ideal.

5. THE SIZE OF THE AGRICULTURAL UNIT.

Having discussed the importance of radical land reform to agricultural development in under-developed societies, it is then proposed to consider the choice between large and small scale enterprise in agriculture.

In some under-developed countries the farms are too large, either in the sense that to increase the number of farms would increase the national income, or in the sense that it would distribute the national income more equitably. Many such countries are engaged in breaking up large estates. In most under-developed countries, however, the problem is exactly the reverse of this: there are too many agricultural holdings. Sometimes the amount of land worked by the average farmer is adequate, but each farmer is working several plots widely separated from each other. Where this is the case, the remedy may be to pass legislation providing compulsorily for the consolidation of holdings.

More usually, the trouble is that there are too many farmers. There is no fundamental remedy for this, except either to bring new land under cultivation, or to create new industries more rapidly

(1) Ibid., Sec. 43, p.

than the population is growing, so that the pressure on the land may be reduced. This is a very urgent problem in many areas. Meanwhile, co-operative farming can be encouraged; and legislation to prevent the further splitting up of holdings may also be required.⁽¹⁾

The family farm is the ideal of most democratic peoples, and in the long run it can develop a high level of efficiency as a result of the incentives of working on one's own account. Where economies of scale are significant the efficiency of the family farm may be supported by organising some functions co-operatively or through government agencies, e.g. credit, marketing or machinery pools. Nevertheless, where economies of scale are significant the small farm has to face the challenge of alternative systems of potentially high efficiency.

6. AGRICULTURAL SYSTEMS.

In the organisation of agriculture, the simplest arrangement is for the farmer to own the land which he cultivates in co-operation with his family. This plan has its recommendations: give a man secure tenure of a rock and he will turn it into a garden, give him a nine years' lease of a garden and he will turn it into a desert. But the scheme has its drawbacks relative to time, place and circumstances. While it ensures that assiduous attention shall be paid to the tilling of the land, it cannot

(1) Ibid., Sec. 69, p. 25.

ensure that the land shall be treated in an enlightened fashion and with adequate capital. And when it is not supplemented with some form of co-operation, a deplorable lack of economy in marketing results. Moreover, under peasant proprietorship, there may be a danger of excessive division of holdings. Besides, the abler peasants will not find it possible to acquire all the land that they could manage because of its cost to purchase outright. Many who are best qualified to cultivate the land may have no chance of getting any at all. Some of these disadvantages of peasant proprietorship may be minimised by associating with it a leasehold system as well as by adopting some form of co-operation. Peasants may unite for the attainment of limited ends by co-operation, since small producers are placed at a disadvantage in competing with large producers in certain fields of production. For this reason, they may combine in order to enjoy co-operatively the economies of large scale. For instance, they may possess specialised agricultural machinery on a collective basis; they may buy seeds and manure jointly, and jointly arrange with the railway companies for the carriage of their produce. The co-operative dairy also seems to have removed a disadvantage at which the small dairy farmer is evidently placed.

In the organisation of agriculture there is also the metayage system. It is a system which in fact is intermediate between peasant proprietorship and the leasehold system. Under it farms are united in estates over which rights are exercised by persons

who are called landowners, though the land may not by custom be theirs to do with just as they like. Broadly understood, metayage exists in a variety of forms in many parts of the world, and in some of these forms it shades off into the leasehold system. The landowner furnishes a portion, if not the whole, of the capital; and the character and the extent of the cultivation is generally made a matter of arrangement between him and the cultivator. Though the liberty of the cultivator is restricted and there may be a fear lest the methods of farming should become stereotyped, the enterprise of the cultivator may actually be stimulated, and given opportunities, by a good landowner whose intelligence will probably be more highly trained than that of the average peasant. As the landowner is a partner, he appropriates some of the produce as his remuneration; his share is some agreed proportion of the whole. It has been objected to metayage that, as the landowner takes a certain proportion of the produce, the inducement to the cultivator to do his best is partially obliterated and he will therefore work the land less intensively. This objection might be fatal, were details as regards the working of the holding not settled by arrangement between the landowner and the farmer. It would not seem, however, to be serious in practice, especially in view of the tendency to excessively intense cultivation as regards the application of labour to the land on small holdings. But metayage has the merit of providing that the burden of the payment made to the landlords by the cultivators

shall be automatically reduced in bad years, as it is not when farms are leased at a fixed annual charge. Theoretically, under metayage, the size of the farm is readily adapted to the capacity of the cultivator, though actually tenacity of custom has curtailed adaptability in this respect.

In the leasehold system, however, the leaseholder is left with a freer hand than the metayer, but he is seldom permitted to alter the character of his farm without the consent of his landlord, and is naturally required to keep the state of the property up to a certain level. Whether the greater liberty which the leaseholder enjoys is a gain or a loss from the public point of view, or his own, depends in chief upon the initiative, resourcefulness and knowledge of the cultivator. Freedom to make endless mistakes and muddle into embarrassment is a doubtful boon.

For the attainment of the most fruitful results from the leasehold system, however, it is essential that the land should be leased for a period which will be lengthy enough to make it worth the farmer's while to spend himself and his resources liberally upon the land. It may be added that arrangements for compensation for unexhausted improvements, which are equitable both to tenants and landowners, have the good effect of preventing the waste of time, land and capital, which otherwise is unavoidable when a lease is drawing to a close and the farmer is chary about investing fresh capital in the land, and is anxious to squeeze out of it every atom of value. With all its good points, the leasehold

system is unsuited to the remote districts of new countries, where farms have to be made out of rough land, unless the lease is an exceedingly long one. A large reward must be offered to persuade the cultivator to endure the toils and discomforts and face the dangers and solitude of pioneering.

7. THE SYSTEM OF INHERITANCE.

Finally, reference has to be made of the system of inheritance which is closely related to the concept of the family. Whenever in a society the legal framework lays down the rights of private property, the rights of inheritance will stem therefrom, and the law will stipulate the way in which the private property of one member of a family on the occasion of his death, i.e. his legacy, will be distributed amongst other members of the family, and its rights will be legally transferred to them. This principle of inheritance is held by many to constitute another weakness of the family system in so far as economic progress is concerned. The testator bequeathes to his heir or heirs his own property after his death. These rights of property and inheritance are recognised in all capitalist societies, and to some extent in such societies with mixed economy and socialist elements as that of the United Kingdom where these rights are still maintained but meanwhile much curbed through heavy taxation on legacies. Controversy over such rights is linked with the serious allegation that the transmission

of property by inheritance has established an institution which may discourage all the incentives to progress.

Supporters of private property stand on the ground that nothing promotes efficiency so much as private property. Rightly or wrongly, man is by nature an acquisitive animal, and his passion for wealth and power has been the main driving force of progress through the ages. Deprive him of the outlet for this instinct, as would be the case if private property were abolished, and the strongest of all the incentives to progress would disappear. Men vary greatly in intellectual and in other abilities, and these natural differences find expression in the corresponding inequalities arising from the institution of private property, and this is, on the whole, to the benefit of society.

Many of the worst defects in private property have been corrected by the actions of the State. Great inequalities of wealth, arising from private property, have been diminished by income and sur-tax, and by death and inheritance duties. Even the right of inheritance, although not free from defects, is not wholly an evil. It gives expression to a fundamental family instinct; a man's will to work and to save is greatly stimulated by the ambition to leave an inheritance to his children, and it is probable that the balance between spending and saving would be seriously disturbed if inheritance were abolished by the State.

Specific fiscal measures may be so designed as to redress the defects of inheritance. The Rignano type of death duties,

for instance, is based on the principle that the tax on an inherited fortune should be graduated according to its age, i.e., the number of times it has already changed hands by inheritance. The greater the age of the fortune, the higher would be the tax rate. Death Duties of such a type would amount to a differentiation between "earned wealth" and "unearned wealth". They induce individuals accumulating wealth to work and save, and by reducing the expectations of prospective inheritors they create in the meantime strong incentives to working and saving.

CHAPTER 14

SOME OTHER ASPECTS OF ECONOMIC PROGRESS

1. BIOLOGICAL AND GEOGRAPHICAL ASPECTS

It is sometimes maintained that different races have inherently different elements of progress owing to differences in biological structure. This, is, indeed, the residual factor that cannot be explained in terms of sociological science.

Geography, on the other hand, offers another explanation. Much obviously depends on the character of the physical environment, or of the natural resources considered as factors of production. Here are involved such things as the character of the soil, the forest resources, topography as favouring or hindering cheap transportation, mineral resources, the availability of water-power, and rainfall and temperatures. At any given time, countries that possess such natural resources as are adequate to technology will most probably take the lead in economic progress. This proposition, however, can hardly be true all the time. On the one hand, we know of some under-developed countries which would potentially be progressive had they made use of available resources. But the state of technology in these countries might have been so poor that any significant use of their economic potential would scarcely be feasible. On the other hand, even if the state of technology would initially make possible the economic disposal of the natural resources, this does not mean

that the technological advancement would go on incessantly. The time may come, sooner or later, when technology changes no more, and stagnation would set in despite the sufficiency of the scarce resources of Nature.

Again, geography suggests that countries situated on the sea routes are accessible to foreign trade. It is not surprising that countries in such a favourable geographical situation will start trade relations with others, make money and become richer, and hence have ample opportunity to bring economic progress to a head. On this issue, empirical evidence is available. China's stagnation is explained primarily on the grounds that the Chinese were very suspicious of the foreigners to such an extent that they were in favour of an isolationist policy, and thus they handled an insignificant volume of foreign trade confined only to one port. When they deliberately excluded foreign trade, the Chinese excluded meanwhile the very elements of economic progress. Although this argument, in theory and in practice, seems to be true in large measure, it is by no means true in each and every case. Some countries, it will be observed, have been open to foreign trade for many decades, and still they were, and always are, economically backward.

Geography also suggests that climate, too, is one of the most important pre-requisites of economic progress. This can only be achieved in temperate climates, but in hot as well as cold climates, human life becomes so intolerable that people living under

these unfavourable climatic conditions tend to be apathetic and inactive. Again one might question the validity of this argument. Historically, it is well-known that almost all ancient civilisations began in hot countries, and these were indeed ahead of other countries simply because the technology of their time enabled them to take the lead in economic progress.

As Viner has pointed out, an unfavourable physical environment can be a major obstacle to economic development. That it needs not be a fatal obstacle, however, that it can be overcome by high quality in its human resources, is demonstrated by the case of Switzerland. Except for the one advantage of its strategic location across some major trade routes, Switzerland has scarcely a single physical advantage for economic development. Nevertheless, in wealth per capita it ranks near the top, and it ranks high also in per capita income.⁽¹⁾

2. PSYCHOLOGICAL ASPECTS

That the psychological factors are no less relevant and important in the study of the causes of progress and stagnation is a commonplace. Economic progress will not be desired in a community where the people do not realise that progress is possible. Progress occurs only where people believe that man can, by conscious effort, master nature. This is a lesson which the human mind has been a long time learning. Where it has been

(1) Jacob Viner, *International Trade And Economic Development*, Oxford, 1953, p.103.

learnt, human beings are experimental in their attitude to material techniques, to social institutions, and so on. This experimental or scientific attitude is one of the pre-conditions of progress. The greatest progress will occur in those countries where education is widespread and where it encourages an experimental outlook.

Even where people know that a greater abundance of goods and services is possible, they may not consider it to be worth the effort. Lack of interest in material things may be due to the prevalence of another-worldly philosophy which discourages material wants. It may also be due to a relative preference for leisure. In the latter case, the amount of work people wish to perform will be small, but they will not necessarily be averse to measures which increase the productivity of such work as they do. A high preference for leisure is not consistent with great material possessions, but it is not necessarily inconsistent with economic progress.

Alternatively, people may be unwilling to make the effort to produce wealth if the social prestige which they desire is more easily acquired in other ways. Thus, in feudal or aristocratic societies where power is inherited rather than earned, and where little respect is accorded to wealth which has been created in the first or second generation, the energies of ambitious men are not attracted so much to the production of wealth as to the acquisition of skills which may secure entry into the strongholds

of power - to the acquisition of military skill, or the skill of the hunt, or the skill of the lawyer or priest. In such societies, the production of wealth is frequently held in contempt as a profession for well-bred young men. By contrast, economic progress is rapid in countries where the successful organisers of economic activity are among the more highly prized members of the community. (1)

3. ENGINES OF ECONOMIC PROGRESS

Throughout it is contended that social institutions, e.g., the ruling class, religion, and the family, are sometimes inimical to economic progress. It now remains to see how the existing social institutions can be thrown overboard by the creative minority. Wars, plagues, famines, volcanoes, earthquakes and the rest of the list of crises of human life are the very conditions in which the social framework can be easily loosened up and the society becomes well adapted to the desirable social transformation. These conditions can then be metaphorically called the engines of economic progress.

In Toynbee's exposition of his twenty-six civilisations, his main thesis is that, time and again, societies are liable to some shock of one kind or another. Whenever these historical events take place, societies begin to move and undergo fundamental changes in their structure. Consider, for example, the historical event

(1) C.f. United Nations Report on Measures For The Economic Development of Under-Developed Countries, May 1951, p.13.

of war and its repercussions on a society. It is true, to some extent, that victory in war may carry with it the very symptoms of social breakdown and disintegration. We know that ancient empires, built up as they were on conquest and warlike achievements, did not last long before they eventually gave way to collapse and decay. The Arab State which expanded far and wide by successive invasions ultimately disintegrated when its rulers presumably took to luxury and settled down to a life of wealth, splendour and indulgence in pleasure. But this does not necessarily mean that a society should be defeated, for complete defeat would lead to degeneration or even annihilation.

As a pre-condition of economic progress, war is also significant for it provides the new men in the society with their real opportunity. Lenin, for example, was an opportunist, and the occasion of war as a social shock was a fundamental element in his opportunist doctrine. In this sense it can be explained why he strived to convert an imperial war into a communist one.

Let us again consider the impact on the social structure of another social shock such as the event of a major earthquake. Society loosens up; destruction is everywhere; the link with the past is lost; and traditional ties fade away. After this misery is over, new men start to build up a new society in which the newly established institutions would be conducive to economic progress.

4. SUMMARY AND PROSPECTS

To sum up, economic progress begins with a social shock which will inevitably loosen up the society and create the very conditions in which new men emerge. If the society is accessible to foreign trade, this enables these new men, impressed by foreign experience, to disintegrate the existing social structure which is inimical to progress. Ancient philosophies have to be scrapped; old institutions have to disintegrate; and bonds of caste, creed and race have to be removed. But the fact that the people of a country must desire progress is no less important than the creation of a new social framework which is favourable to progress.

But if one looks at the world of reality and explores the possibilities of progress among the different countries of the East, one will be much disappointed at the fact that most of the Eastern countries have economically been backward for so many decades. Social shocks of one kind or another are not infrequent. Again and again, wars break out in different parts of the world at short intervals, and within thirty years the world has witnessed two major wars. Other miseries of life are not lacking in intensity or frequency. Famines may be disguised by way of relief action on basis of international co-operation in welfare, but they are there in varying degrees and intensities. The neo-Malthusians are once more freezing our blood with tales of what will happen if output does not keep up with population. What,

then, is the stumbling block in the way of rapid economic progress? What social institutions do not easily disintegrate in practice?

In the writer's judgment, it is the institution of the ruling class that is the key to the solution of the problem of economic development in under-developed Eastern societies. So long as the ruling class succeeds in preserving its power and privileges, so long will the way be barred to economic progress. The conservative ruling class must be overthrown and denied all privileges, and another progressive class established in its place. The new leadership would then inspire the masses and win their confidence; it would demolish the old and build up the new.

THE ECONOMIC ASPECT

Having discussed the circumstances, it is now proposed to consider the new treatment of the policies which promote progress. Already, a new society is being assisted by foreign experts and launched by new methods. The chaotic past, characterized by individual progress, is being replaced by a new system to promote economic progress.

PART IV

The starting POLICIES WHICH PROMOTE
If the national dividend PROGRESS.

and the quality of factors of production except for labour. As the only be desirable if we are to existing level of resources. In under-employment and points of view.

CHAPTER 15.

THE DEMOGRAPHIC ASPECTS OF ECONOMIC DEVELOPMENT.

Having discussed the circumstances in which economic progress emerges, it is now proposed to discuss the second set of questions in the new treatment of the theory of economic development, namely the policies which promote progress. As has been pointed out already, a new society is created and inspired by new men and assisted by foreign experience. If now a new leadership is launched by new men who emerge out of the ruins of the traditional, chaotic past, overthrowing the reactionary ruling class that was inimical to progress, it might then be asked: What should they do to promote economic progress?

The starting-point in this discussion is an obvious proposition: If the national dividend is to be increased, then both the quantity and the quality of factors of production have also to be increased, except for labour. An increase or decrease in labour power can only be desirable if account is taken of the the size of the existing population in relation to the community's available resources. Let us turn, therefore, to the problem of population in under-developed countries from both the static and dynamic points of view.

1. THE 'STATIC' PROBLEM. OF POPULATION IN UNDER-DEVELOPED SOCIETIES.

The problem of rural overpopulation is a characteristic feature of peasant economies that stretch all the way from south-eastern Europe to south-eastern Asia. Chronic and large-scale underemployment in agriculture is what countries of this type have in common. There is a tremendous waste of labour; and labour, we are told, is the source of all wealth. What this implies in regard to capital formation is the so-called concept of 'disguised unemployment'.

Densely populated communities suffer from large-scale disguised unemployment in the sense that, even with unchanged techniques of agriculture, a large part of the population engaged in agriculture could be removed without reducing agricultural output. The same farm output could be got with a smaller labour force. The proviso that this is possible without any improvement in technical methods is important. With better techniques, one could always take some people off the land without reducing output. But here apparently we have a state of affairs where this can be done without any change in methods.

Thus the departure of the excess population would be a big change in itself and would inevitably involve some other changes. But the changes that we exclude here are technological advance, more equipment, mechanisation, better seeds, improvements in drainage, irrigation, and other such conditions. We exclude these

changes here only in order to isolate the possibilities that stem from the presence of large-scale disguised unemployment. There is, of course, no question of excluding them from any development programme in practice.

One thing, however, we need not exclude and that is better organisation. If the surplus labour is withdrawn from the land, the remaining people will not go on working in quite the same way. We may have to allow for changes in the manner and organisation of work, including possibly a consolidation of scattered strips and plots of land.

But the term 'disguised unemployment', as defined here, is not to be applied to wage labour. It denotes a condition of family employment in peasant communities. A number of people are working on farms or small peasant plots, contributing virtually nothing to output, but subsisting on a share of their family's real income. There is no possibility of personal identification, here, as there is in open industrial unemployment. In industrial countries unemployment is a glaring waste of resources which is visible to all, and has perhaps for this reason attracted more attention. In an overpopulated peasant economy, we cannot point to any person and say he is unemployed in disguise. The people may all be occupied, and no one may consider himself idle. Yet the fact remains that a certain number of the labour force on the land could be dispensed with, without making any difference to the volume of output.

In technical terms, the marginal productivity of labour is zero.

Some observers suggest that it may even be negative, which would imply that, by removing some people, farm output could actually be increased. The reason for this might be that under existing conditions people actually get into each other's way, so that if some go away those who remain are able to work more effectively. But this seems to be a doubtful and unnecessary assumption.

Changes in technical methods are excluded from the above definition of disguised unemployment. Improvements in methods are extremely important. Experts seem to be agreed, however, that it is rather hopeless to try to introduce better farming methods unless the excess population is drained off first. There is little chance of any substantial advance in agricultural technique until some of the factors of production now engaged in that activity have been removed. This may sound paradoxical, but there is some basis for this view. And in this broad dynamic sense the marginal productivity of labour can perhaps be said to be negative.

This concept of disguised unemployment is typical of many economically backward areas. In these overcrowded areas it is truly a mass phenomenon, due to social, economic and demographic causes. There are no alternative employment opportunities; two thirds to four-fifths of the aggregate labour force work on the land. And of this agricultural population, according to various estimates in the different countries, 15 per cent, 20 per cent, or as much as 30 per cent constitutes disguised unemployment in the sense in which the term has been defined.

In certain south-eastern European countries in the 1930's estimates of the extent of disguised unemployment tended to show that it represented about 25 to 30 per cent of the agricultural labour force. The highest estimates of the degree of disguised unemployment, i.e. 40 to 50 per cent, are for Egypt. The data presented by W.W. Cleland in 'The Population Problem in Egypt' (1936) make 40 per cent seem a reasonable estimate. In a later study by the same author, quoted in Doreen Warriner's work,⁽¹⁾ half the Egyptian farm population is regarded as surplus. Naturally, estimates of this kind are highly tentative, but the importance of this phenomenon seems to be quite significant from the quantitative point of view.

Some economists, however, maintain that disguised unemployment on the land is only a seasonal phenomenon, and that at the peak of the harvest season all the available labour is needed and is actively at work. This is certainly true in some countries, though in others even the peak harvest load might be managed by a smaller labour force if organisational changes, e.g. consolidation of plots, could be carried out. Seasonal under-employment is likely to be significant where an annual crop cycle dominates farm activity, and where this activity has not developed more advanced farming. Even where disguised unemployment is mainly a seasonal matter, the question of making productive use of it still arises and still has important implications in regard to capital formation.

(1) Doreen Warriner: 'Land and Poverty in the Middle East', London 1948, p.33.

Nevertheless, there are countries where the problem is more than seasonal, where a great deal of concealed unemployment exists throughout the year. In Egypt, for instance, the various crops, some of which are harvested more than once a year, tend to overlap so that there is hardly any time of the year when some crop is not being harvested. In such circumstances any underemployment that may exist must be more or less continuous.

Disguised rural unemployment differs in several ways from open industrial unemployment. It differs notably in that it cannot be absorbed by means of an expansion of monetary demand. The inelasticity of agricultural production makes this remedy quite ineffective. The supply of necessities, which are mostly food, is rigid in the short run so that, when monetary expansion takes place, the outcome is merely an inflation of prices. There is the possibility, however, of taking the surplus people away from the land; and anything they could produce elsewhere would be a clear addition to the real national income.

It should be noticed, however, that this is a static picture of the population resources in a society. We look at the population at a point of time and find that a certain proportion of it could be dispensed with in agriculture and shifted to other activities without reducing food output. This is a static view in contrast to the dynamic view which must take account of population growth.

2. THE 'DYNAMIC' PROBLEM.

OF POPULATION IN UNDER-DEVELOPED SOCIETIES.

In recent discussions of disguised unemployment in relation to economic development, it has been customary to treat population growth, like excess population, as a factor determining the need for capital. A fashionable type of calculation has been to estimate the amount of capital 'required' for the productive employment both of the annual increase in the labour force and of the existing surplus labour. The population increment has also to be provided with capital. Socially speaking, population increase means an increase in the demand for capital for extensive investment, as distinguished from intensive investment, in the familiar terminology used sometimes by demographers as well as by economists like Alvin Hansen. While intensive investment means an increase in capital per head and hence in productivity and average living standards, extensive investment in the course of population growth serves merely to maintain the supply of capital per head of the labour force.⁽¹⁾ The investments contemplated under the Colombo Plan may prove to be of the extensive kind, since it seems that they can be expected to do little or nothing, beyond holding the existing per capita position in the face of the continued rapid growth of population in south-eastern Asia.

(1) C.f. Part II, Chapter 8, Sec.2., 'Stagnation Thesis From The Viewpoint Of The Under-Developed Economy, p. 227

Thus if people in an overcrowded underdeveloped area look forward to raising their level of living, they have to have an increased production of foodstuffs and industrial products. But unless the rate of economic development is more rapid than the rate of population growth, the living standard will fall rather than rise. If such an area is really to make progress, it must develop non-farm activities rapidly enough to provide employment for all the increase in its national labour force, and must also create employment opportunities for still more workers so as gradually to reduce the existing surplus population on the land. This is the real task of economic development.

Economic expansion requires capital formation. Effective expansion of industrial employment requires railways, streets, water supplies, buildings, electric power, and other facilities as well as factories and machinery. Extensive, detailed plans for economic development and large amounts of capital resources are required to produce this rate of growth in urban industry and employment. Meanwhile, agricultural, fisheries and forestry production must be increased to provide food and raw material for the expanding industrial population. Corresponding efforts and investments are thus required in farms, forests and fisheries to raise the rural output. Unless a satisfactory minimum rate of economic development in this sense is reached, a continued increase in real income per head can hardly be achieved.

Attention has lately been focused on the possibility of taking

active measures to check the expansion of population in the overcrowded areas. A better balance between production and population, it is urged, can only be achieved if the rate of population growth is effectively slowed down. In the short run, it may be possible to take such active measures as raising the legal minimum marriage age, or spreading the use of contraceptive methods, as is now being done apparently even in India under a national 'fertility -control Policy', or imposing some legal restrictions on polygamy which is sanctioned by Islamic religion. In the longer run, it may be hoped that the dynamic population problem will solve itself through the widespread change in the scale of values which education and urbanisation tend to bring about. Historically, as Western countries industrialised, standards of living per worker rose and an increasing proportion of the population shifted to urban living. This was followed by a gradual reduction in birth rates and in net rates of population increase. Much the same sequence took place in Japan. Whether this sequence will also take place as backward areas industrialise remains to be seen. If any such result is to take place, the rate of economic development in each under-developed country must be fast enough for the real income per head to increase. In order to achieve this highly desirable target, the production of farms and factories must be high enough to ensure that the net amounts available for consumption increase at a faster rate than population, even after the deduction of the amounts to be put aside for domestic

saving and payment of service charges on foreign investment.

Hence economic development is not merely an optional process that can be cut back or deferred at will. On the contrary, it is governed by certain economic principles of its own. The process of development in any country must attain a given speed before it can exceed population growth. Only then can it begin to improve standards of living, reduce excessive farm population and slow down population growth. Unless both the technical methods and assistance and the funds available for development are sufficient to attain that minimum speed, average standards of living will fall and large portions of the world will be governed by the old Malthusian checks. ⁽¹⁾

There is, however, another aspect of the population problem. It is well-known that the world's population increased by slightly less than 1 per cent per annum between 1900 and 1950 (1 per cent corresponding to 24 million additional persons every year). The rate of growth is accelerating, and over the next ten years it is expected to be $1\frac{1}{4}$ per cent per annum. Thus the present prospect is that the world's population may double itself within the next fifty years. These prospects have produced great horror in some quarters, and it is held that the Malthusian bogey is rearing its ugly head again, threatening gigantic world famines unless population growth is quickly checked. But a Brazilian scientist,

(1) C.f. United Nations Report, Methods of Financing Economic Development, Section on Investment Needed For Minimum Speed of Development By F.A.O.

J. de Castro, in 'The Geography of Hunger' ridicules this attitude and maintains that if the world's population were to double in fifty years, this would in no way put uncomfortable pressure upon the world's resources. De Castro's argument is based on accepting an estimate that half the earth is cultivable, and on concentrating upon food, since not enough is known about mineral needs and resources. He believes that the earth could carry four times as many people as it does at present, at a high standard of nutrition. Professor W.A. Lewis in an article on the subject comments that that claim is fantastic, for it apparently implies the cutting down of all forests to get the 50 per cent cultivable land. And, even if De Castro were right, there would still be cause for apprehension since the population could multiply itself four times within the next century and would then have reached its limits. But he is only right in refuting the suggestion that we may already have passed the limits of cultivation. ⁽¹⁾

True, there may still be room for some expansion of the agricultural acreage, for there exists some virgin land in Latin America, in Africa, in the interior of China, and in the islands of south-eastern Asia. Thus some part of the increase in world food supplies over the next two or three decades will come from bringing new land under the plough. In present circumstances, there can be no certainty as to the extent of the expansion of the

(1) W.A. Lewis, Food, Famine and Fertility, The Observer, February 3, 1952, p.4.

agricultural acreage, for emigration of non-Europeans is to-day held up by political restrictions rather than by the lack of empty spaces, and the future of such restriction is a matter of speculation. What is certain is that reliance must be placed in larger measure on increasing the yield of the lands already under cultivation. The question then arises as to whether the backward countries could increase their production by say 3 per cent per annum over the next thirty years. On the side of industrial production this is beyond argument; increases of 5 per cent per annum are a commonplace in the early stages of industrialisation. But with food it is not so simple. In advanced countries the yield of agriculture per acre seems to increase by between 1 and 2 per cent per annum. Technical possibilities in backward countries are much greater, for there is an immense gap between what is known and what is applied. Experts are of the opinion that the yield per acre in these areas could be doubled by using more fertilisers, by seed control, by pest control and by irrigation. In this respect, Lewis argues that, even if only what is already known were applied generally throughout world agriculture, eliminating the primitive techniques of Asia and Africa and of much of Europe and America, the increase in agricultural output would be phenomenal. Even if there is no increase in area and no scientific revolution in agriculture, he maintains, the annual increase in world production of primary commodities can easily

attain a rate of 2 per cent. If science is widely applied, the increase may be much greater. (1)

3. DEVELOPMENT OR NO DEVELOPMENT.

But the pessimists go a long way with Malthus and maintain that there is not much point in trying to increase the food supply. If the world grows more food and hence the living standards of the masses are improved, all that happens is that people will tend to reproduce themselves at a much faster rate. Famine is necessary in some parts, the pessimists believe, to keep the numbers down. The only way out of this dilemma is birth-control. Hence what is desirable is not agricultural development as such, but simply that moneys be willingly voted for birth-control programmes. If a population therefore is being held down only by famine, it would be ridiculous to grow more food since this will cause numbers to increase. To this point of view there can be raised two serious objections. First, there are limits to the rate at which numbers can increase. The natural increase in population is by no means infinite and is not only conditioned by economic forces. Statistical evidence shows that $3\frac{1}{2}$ per cent per annum seems to be almost the absolute maximum at present; but very few countries manage to attain even 2 per cent. Secondly, it is very doubtful

(1) W.A. Lewis, Economic Survey 1919-1939, London, 1949, p.192.

that raising the living standard will bring about an increase in birth rate in the Malthusian sense. It is almost uncertain that any positive correlation does exist between the standard of living and the birth rate. On the contrary, it is historically revealed, as has been pointed out, that the correlation tends to be negative, at least at the later stages of economic development.⁽¹⁾ What does really lie behind this misconceived fear? It is that the rate of population is increasing simply because mortality rates are falling while fertility rates remain almost unchanged; and the fall in mortality rates is due to the spread of medical knowledge and facilities. The rate of growth of population is now first and foremost a function of the extent to which medical services are made available to the people. It is true that the spread of these services is itself to some extent a function of the rate of economic development. But it is widely believed that these factors will remain largely independent. Medical knowledge will spread, and the population will increase, whether economic development takes place or not. Moreover, medical knowledge and facilities and the consequent reduction in disease and death rates will imply an increase in quality as well as size of the population. With greater physical health and vigour, there is likely to be an increase also in productive capacity. Surely this cannot be an entirely unfavourable factor economically so long as the increased

(1) C.f. Part I, Chapter 3, 'Population Theories in Classical Political Economy', pp.92-94.

production potential of the population is fully utilised.

The belief that economic development must inevitably be dissipated in population growth, or that the rate of increase in population can be substantially diminished by refraining from economic development is therefore entirely unfounded. "If you can increase production faster than population can increase," says Lewis, "then the average standard of living will rise and this itself will reduce the rate of population growth. The fundamental proposition of Malthus was that production could not be increased faster than population. This may have been true in his day; but it is certainly not true in our day. We can, if we try hard, increase production faster than population; and, so far as we know, this is the only way to reduce population growth. Admittedly, we know very little about the factors which bring down fertility rates. It is possible that well-organised birth-control propaganda could do the trick, even among the poverty-stricken peoples of India, but this seems to be most unlikely. If we want to check population growth, the safest way seems to be rapid economic development, with all the cultural changes which this implies."(1)

(1) W.A. Lewis, 'Food, Famine and Fertility', The Observer, February 3, 1952.
p.4.

CHAPTER 16

INVESTMENT INCENTIVES:
ADVERTISING AND DEMAND.

It has been pointed out that the theory of capital formation under conditions of disguised unemployment in overcrowded areas rests on both a static and a dynamic view of population resources. It is widely recognised that emigration is not only an academic but actually an unreal solution to the population problem, for it does nothing to stop the population growth at the source. Exclusive reliance on foreign grants, loans or investments is like emigration in that it does not provide a check to population growth. If a backward country really desires to check population growth, the only way is rapid economic development with all the cultural changes which education and urbanisation tend to bring about. The effective mobilisation of domestic saving potential is for this reason a basic initial prerequisite to capital formation and increasing real income per head. But capital formation is not entirely a matter of capital supply, although this is no doubt the more important part of the problem. It is therefore proposed to deal with a number of points on both the demand as well as the supply side. The dichotomy between demand and supply is fully applicable to the forces that govern the accumulation of capital. On the demand side of the problem, however, reference should first be made to investment incentives as they present themselves to the individual investor or entrepreneur. But

investment incentives, as we shall see later, are directly related to the issue of poverty.

1. THE 'INCOME' CONCEPT IN RELATION TO THE UNDER-DEVELOPED ECONOMY.

In dealing with the issue of poverty and prosperity, it is well to recall here the formal definition of the under-developed country as previously referred to.⁽¹⁾ A country of such a type is that which has good potential prospects of raising incomes per head, or of maintaining an existing fairly high level of income per head for an increased population. But while the supplementing of data as to economic aggregates by per capita averages provides essential information about the economy as a whole, this does not suffice to prove that the mass of poverty in the country concerned has been lessened or increased. An under-developed country may embark on a programme of economic development, and later find not only that aggregate wealth, aggregate income, total population, total production, are all increasing, but that per capita wealth, income, production, are all increasing. As Viner has pointed out, all of these are favourable indications of development; but even in combination they do not suffice to show that there has been 'economic progress' in the sense of an increase in economic 'welfare'.⁽²⁾

If it is sometimes argued that the one great economic evil is

(1) C.f. Part II, Chap.8. Sec.1, 'The Meaning of Stagnation in Mature and Immature Economies', pp.224-225.

(2) Jacob Viner: 'International Trade and Economic Development', Oxford, 1953, p.99.

the prevalence of a great mass of crushing poverty, it is then a paradox to claim that a country is achieving economic progress as long as the absolute extent of such poverty as is prevailing in it has not lessened or has been increased. Such a country, however, might be able to meet all the tests of economic development. If its population has undergone substantial increase, but the distribution of its increased wealth and income is largely uneven, the numbers of those living at the margin of subsistence or below may have grown steadily consistently with a rise in the average income of the population as a whole.⁽¹⁾

Not only this, but there are certain conceptual problems concerning the meaning of income, which have confronted investigators in their attempt to compare national income aggregates of advanced societies with similar calculations for under-developed societies. The difficulty arises, not only as a result of different technical methods of organising production, e.g., market economy as opposed to family or subsistence economies, but has its origin rather in the different objectives and ideals which consciously or unconsciously dominate the communities whose individual and social economic activities are being compared. It is these historical and traditional factors, and not merely the state of technique and organisation, which are the basic cause of differences in the nature and form of the 'income' concept as between different societies at different stages of development.

(1) Ibid., pp. 99-100

In the economically less advanced communities, the attempt by the individual to obtain what is called 'income' is an attempt to achieve a social purpose and is not an isolated activity. It is not merely an attempt to create a set of individual values or an abstract entity such as 'an individual income stream'. In such communities the creation of 'income' may best be understood from the angle of social communication, even if the accounting or economic symbolism which is employed in more advanced economies is such as to disguise this fact. What 'income' is, and how it is valued, is determined by the society in which the individual finds himself. "Our actions," says Frankel, "are not solely determined in isolation: they depend also on the influence we wish to exert upon others, and which their activities in turn exert upon us. Just as economic production depends on social co-operation, so the symbolism according to which it is regulated is socially determined."⁽¹⁾ In his view, the problem arises precisely because we are dealing with different value systems and conventions, and thus the concept of abstract welfare has been and is being used as an inadequate bridge between different incomparable welfare systems.

But Colin Clark, in criticising the view of some modern theoretical economists that it is impossible to compare the level of income between two communities,⁽²⁾ argues that exponents of this view "do not realise what an intellectual anarchy they will

(1) S.H. Frankel: 'The Economic Impact On Under-Developed Societies', Oxford, 1953, pp.31-32.

(2) C.f. Colin Clark: 'The Conditions of Economic Progress', 2nd Edition, London, 1951, pp.16-17.

let loose if their theories are adopted." "Deprive economics of the concept of welfare," he writes, "and what have you left? Nothing: except possibly the theory of the trade cycle, where all values may be capable of expression in money terms without the introduction of the concept of welfare." He does not hesitate to make comparisons of economic welfare of different times, places, and groups of people; and in an attempt to make these comparisons he discusses Fisher's and Pigou's well-known formula.⁽¹⁾

In fact Colin Clark provides some data as to the national income per head in some under-developed countries in terms of U.S. dollars, 1939 purchasing power.⁽²⁾ In spite of the above criticisms which both Viner and Frankel have levelled against the statistical concepts of aggregate incomes and incomes per head as

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- (1) The so-called Pigou-Fisher ideal formula gives us the result that the comparative real income per head can be obtained from the geometrical mean of the following two ratios: cost of country A's goods at country B's prices and cost of country B's goods at country A's prices.
- (2) e.g., the national income per head in Peru was \$39 in 1942, Salvador \$25 in 1940, Honduras \$34 in 1942, Mexico \$30 in 1940, Panama \$127 in 1940, Columbia \$69 in 1940, Paraguay \$27 in 1940, Puerto Rico \$122 in 1940, Jamaica \$89 in 1942, British Guiana \$99 in 1942, Egypt \$42 in 1944, Syria \$63 in 1936, Iraq \$49 in 1936, Cyprus \$39 in 1936, Philippines \$43 in 1938, Bulgaria \$47 in 1945; see Colin Clark, *op.cit.*, Table, p.161.

being criteria for the degree of poverty or prosperity, Colin Clark's tentative estimates should convey to us a rough picture of the very low level of living and of the state of pervasive poverty in under-developed societies, at least from the point of view of Western standards. Besides, one should bear in mind that in all the literature on economic development, there is no one single instance where statistical data in terms of aggregates and of averages have not been treated as providing adequate tests of the degree of achievement of economic development.

Even other experts in this field have followed in the steps of Colin Clark, and in a report recently published by United Nations' Department of Economic Affairs they have attempted to compile aggregate income and population statistics as related to five groups of under-developed areas,⁽¹⁾ exposing throughout the hidden assumption on which they are working: that all over these areas poverty is rife and living standards are at comparatively low levels. On the basis of these economic aggregates, the following table shows the income per head which the population of each under-developed area received in 1949.

(1) See Statistical Appendix., p.527.

Table Showing per Capita Income Which the Population of each Under Developed Area Received in 1949.

A r e a	Population mid-1949 (millions)	National Income 1949 (million dollars)	Per Capita Income (dollars)
Latin America	158	24,000	152
Africa, excluding Egypt	178	13,200	74
Middle East, including Japan	94	9,000	96
South Central Asia	436	24,000	55
Far East, excluding Japan	661	26,400	40
Total	1,527	96,600	

On the basis of the above figures, the weighted average income, which the population of the five groups of under-developed areas, as a whole, received in 1949, is calculated to be little more than \$60. Compare this figure with \$54 as representing income per head in low-income countries in 1949, the latter having been compiled by United Nations Statistical Office. ⁽¹⁾

If statistical data in terms of average national incomes are to be treated as providing adequate tests of the degree of achievement of economic progress, then these weighted averages should point again to the world's greatest, most serious, economic problem: the problem of much over half the world's population

(1) See table showing world income in 1949, p. 472

living under conditions of hunger, sickness, premature mortality and acute poverty.

2. THE VICIOUS CIRCLE OF POVERTY.

Under-developed areas, we are told, have remained, and will remain, under-developed. The 'vicious circle of poverty' is a phrase that crops up frequently in discussion of the problem of economic development. It implies a circular constellation of forces which tend to act and react upon one another in such a way as to keep a poor country in a state of poverty. We can imagine, for instance, a poor man who may not have enough to eat. Being under-fed, his health may be weak; being physically weak, his working capacity is low, which means that he is poor, which in turn means that he will not have enough to eat; and so on. A situation of this sort, relating to a country as a whole, can be summed up in the following proposition: 'a country is poor because it is poor'.

This proposition has been made quite clear by Ragnar Nurkse.⁽¹⁾ He states that perhaps the most important circular relationships of this kind are those that afflict the accumulation of capital in economically backward countries. The supply of capital is governed by the ability and willingness to save; the demand for capital is governed by the incentives to invest. A circular relationship exists on both sides of the problem of capital formation in the poverty-ridden areas of the world.

(1) Ragnar Nurkse; 'Problems of Capital Formation in Underdeveloped Countries', Oxford, 1953, p.5.

On the supply side, he states, there is the small capacity to save, resulting from the low level of real income. The low real income is a reflection of low productivity, which in its turn is due largely to the lack of capital. The lack of capital is a result of the small capacity to save; and so the circle is complete.

On the demand side, the inducement to invest may be low because of the small buying power of the people, which is due to their small real income, which again is due to low productivity. The low level of productivity, however, is a result of the small amount of capital used in production, which in its turn may be caused at least partly by the small inducement to invest; and so the circle is complete.

Thus the low level of real income, reflecting low productivity, is a point that is common to both circles. Usually the trouble on the supply side receives all the emphasis. The trouble there is certainly obvious and serious; but the possible block on the demand side, once one becomes aware of it, is also fairly obvious, though it may not be so serious, or so difficult to remove, as the supply deficiency.

Nurkse, however, admits that capital is not everything. "In addition to the circular relationships that plague the capital problem", he says, "there are, of course, matters of unilateral causation that can keep a country poor, e.g., lack of mineral resources or insufficient water or barren soil. Some of the

poorer countries in the world to-day are poor partly for such reasons. But in all of them their poverty is also attributable to some extent to the lack of adequate capital equipment, which can be due to the small inducement to invest as well as to the small capacity to save.

3. THE LACK OF PURCHASING POWER IN REAL TERMS.

J.B. Adam Smith, as well as the Ricardians, seems to take it for granted that men have unlimited demand. Indeed they show no concern over the likelihood of deficiency of effective demand. J.B. Say, for his part, shares the view of the English classical economists, and comes along to expound his famous law that supply creates its own demand. It is that the general demand for produce is brisk in proportion to the activity of production, and that the products created give rise to various degrees of demand, according to the wants, the manners, the comparative capital, industry and natural resources of each country. Owing to the competition of buyers, the articles most in request yield the best interest of money to the capitalist, the largest profits to the adventurer, and the best wages to the labourers; and the agency of their respective services is naturally attracted by these advantages towards these particular channels. (1)

In his famous work, J.B. Say has indeed gone so far as to

(1) C.f. Part I, Chapter 3, Sec.1, 'Thomas Robert Malthus', pp. 101 - 104.

(1) Ibid., pp. 90-101.

contend that the consumption of a commodity by taking it out of the market diminishes demand, and the production of a commodity proportionately increases it. Malthus, in some respects anticipating Keynes, dissents from this traditional concept on the grounds that no permanent and continued increase of wealth can take place without a continued increase of capital, and that the problem which should worry us is not therefore the want of capital but deficiency in effective demand. In this sense, while J.B. Say as well as other classical economists were inclined to attribute the occasional breakdowns of trade to errors of judgment and disproportionate developments of production, Malthus insisted that they were due to an inappropriate relation between saving and consumption and a sluggishness in the response of the disposition to invest.⁽¹⁾ At the time Malthusian arguments fell into neglect; but since then the problem of demand has increasingly been recognised by the neo-classical economists, and the frequent recurrence of severe crises in the industrial world within the last hundred years bears out empirical evidence as to the real existence and significance of the problem.

In under developed countries, it may at first be surprising to hear that there can be anything wrong on the demand side of the problem of capital formation. Backward areas, almost by definition, are greatly in need of capital for the efficient use of their labour and for the exploitation of their natural resources. In these circumstances, the demand for capital in such areas is

(1) Ibid., pp.96-101.

tremendous, but there is here a serious handicap. In terms of private incentives to adopt capitalist methods in the productive process there is the difficulty that stems from the limited size of the domestic market in the early stages of a country's economic development. It is a matter of common observation that in the poorer countries the use of capital equipment in the production of goods and services for the domestic market is inhibited by the small size of that market, by the lack of domestic purchasing power, not in monetary but in real terms. If it were only a deficiency of monetary demand, it could easily be remedied through monetary expansion; but the trouble lies deeper. Monetary expansion alone does not remove it, but produces only an inflationary spiral of prices.

In the exchange economy of the real world, it is not difficult to find illustrations of the way in which the small size of a country's market can discourage, or even prohibit, the profitable application of modern capital equipment by any individual entrepreneur in any particular industry. In a country, for instance, where the great majority of people are too poor, many articles which are in common use in a Western rich country can be sold in a low-income country in quantities so limited that a machine working only a few days or weeks can produce enough for a whole year's consumption, and would have to stand idle the rest of the time. G. Wythe has given us several striking examples. In Chile,

for instance, it has been found that a modern rolling mill, which is standard equipment in any industrial country, can produce in three hours a sufficient supply of a certain type of iron shapes to last the country for a year. In these circumstances the inducement to instal such equipment is lacking. In some cases foreign branch plants which had been established in certain Latin American countries were subsequently withdrawn because it was found that the local market was too small to make their operation profitable.⁽¹⁾

Naturally the individual entrepreneur must take into consideration the size of the market for his commodity or service. He may hope to be able to deflect some of the present volume of consumers' demand in his own favour; but where real income is close to the subsistence level, there is little or no scope for such deflection. The limited size of the domestic market in a low-income country can thus constitute an obstacle to the application of capital by any individual firm or industry working for that market. In this sense the small domestic market is a deterrent to economic development in general.

How can this obstacle be removed? What is it that determines the size of the market? Some may think of the size of a country's population as determining the size of the market. Others may have in mind the physical extent of the country's territory; others, again, may think, in this connection, of monetary expansion as a remedy. All these factors appear to be of secondary importance,

(1) C.f. G. Wythe, *Industry in Latin America*, New York, 1951.

if not irrelevant. Again a popular prescription is that small adjacent countries should abolish restrictions on trade with each other, and set up what is commonly called a customs union. But the smallness of a country is not the basic difficulty; the market difficulty can even exist in very large countries such as India or China.

Still others place much emphasis on high-powered methods of salesmanship and advertising as a stimulation to effective demand. It is therefore worth while to examine the pros and cons of advertising policies as an investment incentive.

4. ADVERTISING POLICIES.

For investment incentives to come into play in the development of any economy two conditions must be satisfied: first, people should work and make money; secondly, people should want the things that money can buy. Are these two conditions fulfilled in backward areas?

Let us first of all consider the condition that people should work and make money. Reference has already been made to the causes of lack of interest in material things. This may be attributed to the prevalence of a moral philosophy which tends to discourage material wants. More important, people may be reluctant to make the effort to produce wealth if the social prestige which they desire is more easily acquired in other ways.

In a society of such a kind, people are not attracted so much to the production of wealth as to the acquisition of skill, military religious or otherwise, and the production of wealth is frequently held in contempt as a profession. The road to power and prestige is by moving in the circles of the ruling class; and thus people who are gifted may be precluded from ascending the social ladder. We are told that in Brazil, for example, much in affairs is done on a friendly basis, and doling out favours to friends and relatives is perhaps the rule rather than the exception. The same is true of many under-developed countries. If this is the road to power and prestige, it is no doubt a serious handicap to development, for if people in general refrain from producing wealth, how can an under developed country be economically developed? We should expect the least economic development where social prestige is mainly to be achieved by way of corruption, friendship and hypocrisy.

It has also been noticed that most of the people in under developed countries do not want the things that money can buy. This is obviously another serious handicap. One may explain this attitude towards work and consumption demand in many ways. It may be psychological in the sense that people do not realise that progress is possible or even if it is possible that they will share in it with the rich minority on an egalitarian basis. It may be biological and that is a residual factor involving differences between races or cultures. Or it may be institutional in the sense that the consumption habits of the people are too rigid

either through their ignorance of better consumption standards or through their reluctance to change their cherished modes of life. If, then, it is the ignorance of better consumption standards that is largely responsible for the negative attitude of the masses towards work and consumption demand, there is a way out of the market difficulty. There is a popular prescription in the form of advertising policies designed to foster consumption demand. In this field of study, Bishop's work⁽¹⁾ may be considered as a premise on which to explore the potentialities of salesmanship and advertising in so far as backward areas are concerned.

Bishop's starting-point is to make a distinction between informative and persuasive advertising. In general, he says, all the vast daily mass of advertising, which may be regarded as strictly informative, may be considered useful and necessary. A large portion of modern advertising, however, is not informative and its primary object is to persuade the public. But not much value can be attached to the distinction between the two types, for they are often mixed and difficult to disentangle. Moreover, all modern advertising is persuasive in character, information being incidental to its main purpose. Private enterprisers, acting under the stimulus of profit motive, appeal directly to the ultimate consumers through advertising so as to stimulate and regulate demand besides protecting themselves against the competition of others by building up a goodwill or a reputation

(1) E.P. Bishop: 'The Economics of Advertising'

monopoly for their products usually differentiated and branded. Thus they assure themselves a steady and profitable market. In a free competitive economy, therefore, production as well as the means of stimulating demand are in private hands. Certain results would inevitably follow: the individual producer is concerned, not to adjust general demand to general supply, but to secure an adequate demand for his own product. Hence most modern advertising is competitive in character and has the effect of splitting up the supply of each kind of a familiar product into a number of differentiated brands.

In the appraisal of advertising, however, the fundamental question is: does advertising serve a useful social purpose? Advertising is, of course, productive in the business sense. A business man judges it by its success or failure in increasing profits. But the real test is whether advertising creates utility in the economic sense. It is not easy to assess utilities created by advertising, nevertheless. Wants are usually in theory treated as data, as something fixed and known; and in theory, too, the manufacturer and the trader are presumed to be rearranging and moving matter in relation to these fixed wants. By contrast, advertising contributes to moving and rearranging matter the other way round, i.e. it creates utilities by moving and rearranging minds, that is by altering wants. And, there is no theoretical means to distinguish between utilities created by making available to the consumer something that he wants and utilities created by

making him want something available to him. Hence the difficulty in discussing the effects of advertising upon the consumers' satisfactions.

Braithwaite (E.J. 1928) distinguishes between informative advertising whose expenses can be legitimately included in selling cost and other advertising designed to create or stimulate demand which is, in his view, non-essential and unproductive. Samuel Courtauld (E.J. 1942), however, argues that advertising has a legitimate function if it is designed to let people know where they can get what they want or if it is an advertising campaign designed to introduce a really valuable commodity, hitherto unknown to the public. Most competitive advertising, other than these two types, is to be considered by Courtauld as a costly national extravagance. In the light of his analysis, there follows a complete denial of the claim of advertising to perform any necessary or useful function in stimulating demand for goods and services. But here Bishop contends that this sort of analysis seems to spring from the failure of classical economists to recognise the need for any stimulation of demand at all. He holds that nearly all advertising gives some information which otherwise would have to be provided in other ways, and to this extent advertising is productive of utility. The essential fact, however, is that all commercial advertising is primarily designed to persuade, stimulate, arouse, increase and change wants; and the real issue, in the economic sense, is whether this aggressive

type of advertising is productive or wasteful.

Although advertising is usually associated with well-developed economies, it is quite clear that it can play a not insignificant part in under-developed economies as well. The case for and against advertising, in so far as the welfare of the consumer is concerned, is presumably well-known in economic literature. Besides, advertising is likely to have favourable effects on the national economy as a whole in both developed and under-developed countries. But advertising has indeed special significance to the latter type of countries. Efficiency is to some extent a function of the scale on which economic activities are carried out. In its widest context, it relates to the size of the market itself. As Adam Smith has pointed out, division of labour is limited by the extent of the market. (1) But the internal markets of most under-developed countries are so small that they cannot support large-scale industries. Anything that promotes the expansion of these markets will do well to increase industrial efficiency in those countries. Advertising will do the trick by ensuring a ready market for new products. Nation-wide advertising campaigns will create national markets which were formerly only local. It is in this sense that advertising is very likely to raise the living standard directly by turning what would have been luxuries for the few into ordinary comforts within the reach of the masses. It assists the productive process in two

(1) C.f. Part I, Chapter II, 'The Theory of Economic Policy in Classical Political Economy,' Section 1, p. 64.

ways: by educating the public to the possibilities and uses of the newly advertised articles, and by so stimulating demand that the producer is encouraged to incur the risks of investment in mass-production plant and mass-selling organisation.

Furthermore, advertising not only raises the living standard directly by bringing new products more quickly into the field of mass production, but raises it indirectly by encouraging further inventions and widening the field for investment and employment. The price of economic expansion and development must be paid by someone, and it is material to consider whether, without the protection which the patent laws on the one hand, and advertising on the other, give to the innovator, the product would ever have reached the stage of being marketed at all.

Advertising is also claimed to stimulate the propensity to consume. It makes people in under-developed economies want things which without a stimulus they would not want. It induces them to work harder in order to obtain the means of satisfying their new wants while the money they earn and spend help to provide others with employment and means of satisfying their wants. Advertising is thus claimed to be useful in keeping the whole economy in order, and particularly in constantly raising the level of the consumption-income schedule in under-developed economies.

Nevertheless, we must not throw ourselves unreservedly on the side of those advocates of advertising who believe that its magic is a cure-all for the problem of demand. A moment's

reflection will lead us to distinguish clearly between the deficiency of demand in economically developed and under-developed countries. The deficiency of market demand that tends to keep down private investment incentives in the domestic economies of under-developed countries is a deficiency of real purchasing power in terms of classical economics. It is not a deficiency of 'effective demand' in terms of Keynesian economics. There is, as a rule, no "deficiency of monetary demand;" there is no "deflationary gap". On the contrary, many of these countries suffer from a chronic inflationary pressure. Money demand, though low in absolute amount, is excessive in relation to the capacity to produce. Supply creates its own demand, but supply is very small. It is small because of low productivity, which in turn is largely due to the lack of real capital. Supply being inelastic as well as small, monetary expansion leads merely to price inflation. Advertising likewise may lead merely to an increase in the willingness, but not necessarily the ability, to work harder and raise the real spending power. The ability to buy depends, after all, on the extent of employment opportunities and the volume of production in under-developed countries. In those countries, therefore, it seems most unlikely that advertising alone will do the trick in the way of breaking the vicious circle of poverty.

CHAPTER 17.

INVESTMENT INCENTIVES:

THE SIZE OF THE MARKET AND THE THEORY OF BALANCED GROWTH.

In the economy as a whole, the circular flow of goods and services produced and consumed is not a fixed magnitude. With a given population, it is a variable depending on people's productive efficiency. We are here in the classical world of Say's law. In under-developed countries there is, as a rule, no "deflationary gap" through excessive savings. Production creates its own demand, and the size of the market depends on the volume of production. In the last analysis, the market can be enlarged only through an all-round increase in productivity. Capacity to buy means capacity to produce. Productivity depends largely on the degree to which capital is employed in production. It is a function, in technical terms, of the capital-intensity of production. But, for any individual entrepreneur, the use of capital is inhibited, to start with, by the small size of the market.

Where is the way out? In economically backward areas Say's law may be valid in the sense that there is no "deflationary gap". It never is valid in the sense that the output of any single industry, newly set up with capital equipment, can create its own demand. Human wants being diverse, the people engaged in the new industry will not wish to spend all their income on their own

(1) Ragnar Nurkse, op. cit. p. 10.

products. And the people outside the new industry will not give up other things in order to buy the product of the industry if they do not have enough food, clothing and shelter.

Thus the trouble is due above all to the inevitable inelasticity of demands at low real-income levels. It is in this way that poverty cramps the inducement to invest and discourages the application of capital to any single line of production. The enlargement of the market through the rise in productivity that would result from increased capital-intensity of production is inhibited by the initial smallness of the market. "We perceive a constellation of circumstances", says Nurkse, "tending to preserve any backward economy in a stationary condition, in a state of 'underdevelopment equilibrium', the possibility of which, in advanced industrial countries, was impressed on us by Keynes. Economic progress is not a spontaneous or automatic affair. On the contrary, it is evident that there are automatic forces within the system tending to keep it moored to a given level."⁽¹⁾

1. THE THEORY OF BALANCED GROWTH.

All this, however, is only part of the story. The circular constellation of the stationary system is real enough, but fortunately the circle is not unbreakable. And once it is broken at any point, the fact that the relation is circular tends to make

(1) Ragnar Nurkse, op., cit. p. 10.

for cumulative advance. What is it that breaks the circle?

The difficulty caused by the small size of the market relates to individual investment incentives in any single line of production taken by itself. At least in principle, the difficulty vanishes in the case of a more or less synchronised application of capital to a wide range of different industries. Here is an escape from the deadlock; here the result is an over-all enlargement of the market. People working with more and better tools in a number of complementary projects become each others' customers. Most industries catering for mass consumption are complementary in the sense that they provide a market for, and thus support, each other. This basic complementarity stems, in the last analysis, from the diversity of human wants. The case for 'balanced growth' rests on the need for a 'balanced diet'.⁽¹⁾

This notion of balance is indeed inherent in the classical Law of Markets which generally passes under the name of Say's Law. J.S. Mill's formulation of this Law is that 'every increase of production, if distributed without miscalculation among all kinds of produce in the proportion which private interest would dictate, creates or rather constitutes its own demand'. "Here, in a nutshell, is the case for balanced growth. An increase in the production of shoes alone does not create its own demand. An increase in production over a wide range of consumables, so proportioned as to correspond with the pattern of consumers' preferences, does create

(1) Ibid., p. 11.

its own demand. It goes without saying that, with a given labour force and with given techniques and natural resources, it is only through the use of more capital that such an increase in production can be obtained."⁽¹⁾

Balanced growth may be a good thing for its own sake, but here it interests us mainly for the sake of its effects on the demand for capital. For it appears here as an essential means of enlarging the size of the market and of creating inducements to invest. But the question now arises, how can balanced growth be achieved? Ordinary price incentives may bring it about by small degrees. But slow growth is just not good enough where population pressure exists. Economic development must reach a minimum speed before it bears its fruits. In the evolution of Western capitalism, according to Schumpeter's theory, rapid growth was achieved through the action of individual entrepreneurs, producing recurrent waves of industrial progress. Many economists in the advanced industrial countries have commonly treated it as a theory of business cycles. In the advanced countries there has been a tendency to take economic development for granted, as something like a natural process that takes care of itself, and to concentrate on the short-run oscillations of the economy. To Nurkse, however, Schumpeter's work, if it is properly understood, is just what its title says it is: a theory of economic development. Business cycles appear in

(1) Ibid., p. 12.

it only as the form in which economic progress takes place.

This theory, as we know it, assigns a crucial role to the innovator, the creative entrepreneur, or rather to the action of a great number of such entrepreneurs and their imitators, carrying out innovations, putting out new commodities, and devising new combinations of productive factors. Even if an innovation tends each time to originate in one particular industry, the monetary effects of the initial investment are such as to promote a wave of new applications of capital over a range of different industries; and these waves in turn result each time in an increased production of consumable goods that constantly deepens and widens the stream of real income. While the money-income effect of investment accounts in part for the bunching of investment activities in the course of the cycle it is the effect of the investments on the general level of productivity that increases the flow of consumable goods and services. This real income effect, even though it may have depressive monetary repercussions in the short run, is indeed the sum and substance of long-run economic progress, provided the composition of the increased output of consumable goods corresponds to the pattern of consumers' demands.

Thus a wave of capital investments in a number of different industries can economically succeed while any substantial application of capital by an individual entrepreneur in any particular industry may be blocked or discouraged by the limitations of the pre-existing market. While any single enterprise might

appear impracticable, a wide range of enterprises in different industries might succeed. This is so because they will all support each other. The people engaged in each enterprise, now working with more real capital per head and with greater efficiency in terms of output per man-hour, will provide an expanded market for the products of the new enterprises in the other industries. And, the dynamic expansion of the market through investment to be carried out in a number of different industries, will remove or at least mitigate the drag it imposes on individual incentives to invest. It is through the application of capital over a wide range of activities that the general level of economic efficiency is raised and the size of the market expanded.

The technical contribution which capital can bring about in backward countries may be great, and the possible increase in physical output with modern machinery, plus efficient management, may be tremendous. But this, Nurkse contends, is merely the engineering side of the matter. The economic side is concerned, not simply with physical productivity, but with value productivity, and this is limited for any individual business by the poverty of potential consumers. "When we think of the primitive methods of production that prevail in most countries," he writes, "and contrast them mentally with the physical productivity of a modern mechanised plant, we readily jump to the conclusion that the marginal productivity of capital in the economically backward areas must be enormous. The case is not so simple. The technical

opportunities may be great, the physical increase in output may be spectacular compared with existing output, but value productivity is limited by the low purchasing power of the people. The technical physical productivity of capital can be realised in economic terms only through balanced growth, enlarging the aggregate size of the market and increasing individual investment incentives all round, while on any single investment project, if it were considered in isolation, the prospective return might be quite discouraging or at all events not sufficiently attractive to make the installation of more and better equipment worth while." (1)

In this connection, too, Nurkse distinguishes between the notion of 'external economies' in the Marshallian sense and this notion in the market sense. Each of a wide range of projects, by contributing to an enlargement of the total size of the market, can be said to create economies external to the individual firm. Indeed it may be that the most important external economies leading to the phenomenon of increasing returns in the course of economic progress are those that take the form of increases in the size of the market, rather than those which economists, following Marshall, have usually had in mind, i.e. improvements in productive facilities such as transport, communications, trade journals, labour skills and techniques available to a certain industry and dependent on the size of that industry.

(1) But Schumpeter's theory of economic development was intended to

(1) Ibid., p. 14.

apply primarily to the rise and growth of Western capitalism. It is not necessarily applicable in the same way to other types of society where it may be that the forces that are to defeat the grip of economic stagnation have to be deliberately organised to some extent, at any rate initially. In the early industrial development of Japan, as has already been intimated, the state was indeed the great innovator and the industrial pioneer on a wide front. (1) Japan's early industrial development seems to have been planned and implemented to a great extent by the state. Later when the main obstacles, among which was the initial market difficulty, had been overcome, the state was able in many cases to turn over to private enterprise the undertakings it had started. Incidentally, it appears that Japan's early industrial development, before 1914, was based predominantly on an over-all expansion of the domestic market; and it was not until later that export markets became important for Japanese industry.

2. STATE PLANNING.

Whether balanced growth is to be enforced by state planning or achieved spontaneously by creative entrepreneurs is a much controversial issue and essentially a question of method. In other words, it is the administrative form of the economic nature of the

(1) C.f. Part III, Chapter 10, 'The Agents of Economic Progress', Sec. 1. pp. 262 - 264, Sec. 2, pp. 267 - 269

solution to the market difficulty. The nature of the solution is balanced growth, but the question of method must be decided on the basis of broad considerations: the human qualities and the motive forces existing in any particular society. Broadly state interference must be dependent, after all, on the extent of the power, intelligence, and the spontaneous initiative, possessed by the public. This of course will vary as between countries. The American economy, for instance, has been largely supplied with the human qualities of enterprise and initiative which it may be said to cover the bulk of the people; but we must not take it for granted that these human qualities are present in the same degree elsewhere. In the industrial development of Western Europe the main source of these qualities was the middle class.

But if the middle class is almost non-existent, and hence the human qualities of enterprise and initiative are lacking in a society, we may expect that much reliance is to be placed on the state in so far as the development of the national economy is concerned. Most under-developed countries are well-known examples of this. Indeed some authors have attached great importance to state planning as an essential mechanism for development in those countries. They emphasise that "economic progress depends to a large extent upon the adoption by governments of appropriate administrative and legislative action, both in the public and private sectors."⁽¹⁾

(1) United Nations Report on Measures For The Economic Development Of Under-Developed Countries, New York, May 1951, Sec. 39. p. 17.

If then development is largely a matter of 'public will' in backward countries, would it seem doubtful, following Professor Frankel, whether a history of economic change, of innovation, or of economic growth in different societies supports this optimistic view of the role and capacities of governments?⁽¹⁾ The authors of the United Nations Report, however, have this serious criticism in mind when they remark that "the first thing that is demanded of governments is that they should be efficient and honest. This is hard to achieve in any country, and is particularly hard in some under-developed countries where skilled technicians and administrators are scarce, and where traditions of honest administration are lacking."⁽²⁾

The authors indeed have stressed that governments must discharge efficiently the functions which are everywhere expected of them, and devote to these functions a sufficient proportion of their budgets. They must ensure that an adequate proportion of the national income is devoted to roads and communications, to education, to public health, and to other public and social services which will improve the social condition of the people, their physical strength and intellectual powers. In addition to the functions which all governments usually perform, there is a large

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- (1) C.f. S. Herbert Frankel, *The Economic Impact On Under-Developed Societies*, Essay V., United Nations Premier For Development, p. 85.
 (2) United Nations Report, op. cit., Sec. 41. p. 17.

borderland of functions which they have to perform, not only because they are essential to the process of development; but they are not carried out, or carried out insufficiently, by private enterprise, e.g. market research, prospecting and geographical surveying, agricultural experimentation and extension services, and the assessment of the prospects of new industries.

A second borderland function goes a stage beyond prospecting, and actually establishes and operates new industries which are neglected by the private sector, either through lack of knowledge, or through fear of risk. Japan is often cited as an illustrious example. This type of operation played an important part in initiating industrialisation in that country during the nineteenth century, when the Japanese government established new industries and subsequently sold or leased them to private entrepreneurs.

A third borderland function is the creation of financial institutions to mobilise savings and to channel them into desirable private enterprise. The provision of capital to the small private farmer and artisan, for instance, is an urgent way of increasing productivity, but is often neglected by commercial institutions. Similarly, in countries where there is little experience of manufacturing, it is difficult to mobilise capital for new industries without the help of publicly supported industrial development banks.

Besides, there is another borderland of functions which the private sector is anxious to perform, but which it performs at

excessive cost to the public. It covers those industries where the wastes of competition would be so great, relative to the wastes of monopoly, that these industries are best conducted as monopolies, e.g. certain kinds of public utilities, of agencies for marketing agricultural produce, and of factories for processing the output of small farmers. In some cases, the appropriate remedy is to organise co-operative marketing or production; in other cases, the appropriate remedy is to impose legal controls on the private monopoly; and in still other cases the appropriate remedy is public operation.

Beyond this borderland lies the economic sector in which private enterprise operates as efficiently as public enterprise, if efficiency is to be measured in terms of the ratio between the input of resources and the output of product. Although in most countries this economic sector is left to private enterprise, there is much controversy over its size. In the first place, there are some economic activities which some governments wish to reserve to themselves either because of defence purposes and public safety, e.g. the oil industry or the manufacture of armaments; or because some industries are considered to be basic, e.g. public utilities. In the second place, some people believe that the rewards demanded by private entrepreneurs are always too high, and that this is particularly so in under-developed countries. Economic development by private enterprise requires the government to co-operate with, and sometimes even to woo private capitalists. If it tries to

regulate them too closely, enterprise may be discouraged; and, indeed, in any case the power of private capitalists may well be so large that they inevitably dominate the government instead of the government being able to control them. This is suggested as the reason why economic development by private enterprise is often associated with the creation of large private fortunes. (1)

When this is the case, no half-way house is possible between development by the enrichment of private entrepreneurs, and the alternative of confining new industries to public enterprise. In this case, the under-developed countries have a difficult choice to make. When new development is confined to public enterprise, its speed will be determined by the rate at which governments can mobilise capital, skill and enterprise, and its efficiency will be determined by what governments (often rather weak) can manage to attain. We do not have to commit ourselves on this issue, or on the other very controversial question whether public operation is not also preferable for non-economic reasons, even where it is not more efficient than private enterprise. Every country must decide for itself where it wishes to draw the limits of the public sector. (2)

(1) United Nations Report, op. cit., Sec. 51. p. 20.

(2) Ibid., Sec. 52, p. 20.

CHAPTER 18.

ENTREPRENEURIAL INCENTIVES:

LEGAL AND ADMINISTRATIVE POLICIES.

1. THE LEGAL FRAMEWORK AND ENTERPRISE.

So far we have been discussing the concept of balanced growth as a main pre-requisite for enlarging the size of the domestic market in low-income countries. We have also been discussing the serious problem of technical discontinuities which are partly due to the fact that real capital equipment, which is produced in industrially advanced countries and adapted to their domestic mass markets, is not suited to conditions in low-income countries where domestic markets are comparatively very small.

All this, however, is superimposed on the fact that in communities afflicted with mass poverty the qualities of enterprise and initiative are usually in short supply, and the demand for capital tends to be sluggish for this reason alone. Thus for any detailed study of investment incentives on the demand side of capital, there must be taken into consideration the possible ways in which the three factors, namely, inelastic consumer demand, technical discontinuities and lack of enterprise, can keep down the demand for capital in low-income countries. Thus it remains to be seen why the qualities of enterprise are often in short supply in almost all under-developed societies.

which First of all, in societies where people are left to private enterprise, initiative will be weak unless the property institution creates incentives. Private enterprise and communal property are not always consistent with each other and economic progress. Private property as an institution increases the incentive to save and invest, and the magic of property, we are told, turns sand into gold. We may recall David Hume's argument in favour of the theory of property: one can conceive circumstances in which the property institution would be unnecessary or in which it would have to be superseded, e.g. in a state of abundance, or a state of siege, or a state of universal benevolence. But in normal circumstances, where the means of satisfaction are scarce, and where self-love and family affection are so much stronger than general altruism, it seems the most workable basis for order in social life.⁽¹⁾

Besides men are in general unlikely to make efforts if they are unable to secure the fruits of their own labour. Very little progress therefore is to take place in countries where governments are too weak to protect property, or where they arbitrarily requisition property, or where civil disorder is endemic.

Defects of the law are also frequently a reason why a man cannot secure the fruits of his efforts for himself. For example, the law governing the relations between landlord and tenant may not adequately protect the right of the tenant to unexhausted investment

(1) David Hume, *Treatise on Human Nature*, Book III, Part II, Sections I-V.

which he has made in the land. Moreover, the stealing of crops is sometimes a chronic problem, for people in low-income countries are sometimes tempted to steal crops, especially where overpopulation and sheer poverty dominate the agrarian life. This phenomenon has made it imperative in some regions to have the lay-out of the village in such a strategic way as to keep constant watch over the safety of crops. It is alleged that peasants in Jamaica grow less than they can grow simply because they cannot secure the safety of a greater amount of crops. Had there been no vile practice of this kind, no frequent action of robbery, more crops would have been planted and more material welfare procured.

No less important in respect of the insecurity of the fruits of efforts is the arbitrary exactions by the government. Whatever may be the tax structure, it must be known in advance and must give the opportunity for the people to adjust their economic activities accordingly. With arbitrary levies, people are very likely to diminish their commitments in any way. Furthermore, the rates of taxes should not be so high as to be a deterrent to the enterprising spirit. It is feared that any intolerable increase in the scope and rate of taxation, following the modern fiscal systems in Western economies, would be a serious obstacle placed in the way of developing a young economy, since it would necessarily act as a brake on individual efforts and initiative. But if the tax structure must not be so high as to act as deterrent to progress, what test is to be applied in this respect? If it is the 'taxable capacity', as

it might be suggested, this is a dubious term which cannot be easily defined in strict accuracy. In theory, there seems to be no accurate test, and it should be left to the discretion of the public authorities to draw the line beyond which any increase in taxation would, in their sound judgment, be injurious to the development of the national economy.

Another common factor making for the lack of enterprise in many agrarian societies is the indebtedness of the great majority of peasants to money-lenders. The peasant, who has been plunged into debt, will soon find out that the produce of his land can scarcely service the debt charges; any surplus will not increase his earnings but will only be pocketed by the money-lender. It is unlikely that the peasant will feel moved to work harder and increase output when self-interest is lacking. In some countries legislation has been introduced to cope with this problem; it has laid down that debts have to be scaled down by limiting the amount which a peasant can borrow. Within that limit it is conceived by legislation that the peasant will be in a position to overcome the shortage of cash to buy the requisite materials and implements of agriculture. In some other countries, legislation has been passed, forbidding peasants to borrow and courts to entertain any action brought by money-lenders or traders for repayment of debt. The ultimate end of these different legal measures is evidently to prevent farmers from getting into debt, and hence to remove a serious obstacle in the creation of the incentive to work and

enterprise. For the finance of real capital requirements of agriculture and industry, most governments have established public financial institutions for lending to private enterprise, i.e. farm credit institutions and industrial development banks.

In the second place, producers may not only be denied the fruits of their efforts as a result of the serious drawbacks in the legal framework, but may also be prevented from innovating or applying new productive methods by custom or by law. In some societies, for instance, the techniques and rituals of agriculture are prescribed by priests, and the innovator will be committing a grave affront. Or, the technique may be prescribed by law, as was stipulated in the edicts of Colbert, the seventeenth century French statesman. It is well observed in Fisher's and in Hilton's works that, even in the more advanced societies, pressures are frequently organised, on the part of some producers and workers alike, to prevent or retard the adoption of technological improvements. ⁽¹⁾

The only difference between the two cases seems to be that, in the more advanced societies organised pressures to prevent technical progress are sometimes, but not always, exerted from below, whereas in the less advanced societies pressures are often exerted from above, either in the form of firmly-rooted customs, or legislation passed by a reactionary ruling class, or else in the form of a religious code of economic activity.

(1) C.f. Part II, Chap. 6, 'The Clash Between Security And Material Progress,' pp. 157 - 196

In the third place, it may also be that the social system is such that potential enterprisers may be denied opportunity as a result of the great inequalities of income and wealth.

The masses of people, who are kept ignorant, would have contributed to the process of economic development if they were given the opportunity. But potential enterprisers may also be precluded, by monopolistic organisation of production, from entering into trade or industry. Sometimes, this results from the concentration of wealth in a few hands; or it may be the organised pressure of a number of small producers, banding together to protect themselves against competition. In either case, the monopoly may be backed also by legal restriction on free entry.

Rapid economic progress is bound to damage some persons whose fortunes are tied up with old techniques.

Furthermore, the social system may also deny to potential enterprisers the resources they need for organising new units of production. Thus it may not be possible to recruit labour, because it is tied to the soil by law, or because caste restrictions prevent labour from moving to new occupations. Or, land may be concentrated in the hands of a small number of individuals who are unwilling to sell it to individuals outside their group. Or the banking system may discriminate against borrowers of a particular race or creed. Horizontal mobility of resources is, like vertical social mobility, a pre-requisite of economic progress.

Besides the need for redressing the aforementioned defects in the legal framework, which may account in larger measure for the

lack of enterprise in under-developed societies, much importance should also be attached to the Company Law. It should be so framed as to cater for protecting the interests of all parties concerned, each party being ensured the procurement of his fair share of the produce in return for his efforts in the productive process. Moreover, cases may arise in which social costs in the Pigovian sense may not be adequately compensated for and taken into account by private entrepreneurs; so also are the social benefits. This is an important issue and the state has to pass such an appropriate legislation as to cope with problems arising from the emergence of social costs and benefits, as distinct from private costs and benefits. Many instances of this kind are cited in economic literature. In his well-known work, 'Economics of Welfare', Pigou discusses the problem in great detail. Take the instance of smoke or deforestation. Individual action, bringing about smoke or cutting down forests will have a wider effect over a whole area. Hence legislation should aim at the protection of forests and the wiping out of the cost of smoke to the inhabitants, either by specifying the appropriate location of factories, or by levying a tax on the producers of smoke in favour of the society. Similarly, adequate legislation should be passed in respect of systems of drainage affecting public health, or epidemic diseases, or plant diseases which may annihilate flourishing plantations and scale down any prospects of good harvests.

Finally, the relationships between tenant and landlord should also be the subject-matter of legislation. This is, indeed, of utmost importance in backward countries where the farming element is predominant. The legislation should countenance the gravity of the problem and look at it from the angle of equity, making it difficult to displace tenants from their holdings by landlords unless it is proved beyond dispute that the tenants pursued bad husbandry detrimental to the interests of farming in general. Adequate land tenure legislation should assure the cultivator enough continuity and a sufficient share of the increased fruits of his labour to induce him to invest all the capital needed in the venture, to adopt the most improved techniques suitable to his circumstances, and to put forth intensive effort for increased production. The typical productive unit in most under-developed countries is the family farm, and its present efficiency can also be increased by appropriate legal measures.

Thus the legal framework in under-developed countries needs to be overhauled. Laws relating to property, inheritance, land tenure, companies and risk-bearing should fundamentally aim at the principle that each person should reap the fruits of his labour, and, moreover, should not be denied the opportunity or the resources to innovate, initiate and enterprise. Joseph J. Spengler sums up these matters in the following statement:

"Industrial progress is markedly dependent upon (a) the relative number of imaginative and energetic innovators and

entrepreneurs present in the population, (b) the extent to which these qualified persons are empowered to make and execute relevant decisions, and (c) the degree to which these individuals are free of hampering legal and institutional arrangements. In the past this distribution has been most favourable in countries possessing a comparatively strong 'middle class' that enjoyed sufficient support at the hands of the state; while countries lacking a sufficiently strong middle class have had to depend upon the state to provide entrepreneurial leadership in so far as possible."⁽¹⁾

But how can this public entrepreneurial leadership be supplemented by private entrepreneurship at the early stages of development in countries where the middle class is almost non-existent or at best insignificant? How can this private entrepreneurship be promoted, not only in the sense of removing such legal and institutional arrangements as may hamper the course of industrial progress, but in the sense of training would-be business executives?

It is a commonplace that the entrepreneur, in all various aspects of entrepreneurship, should have some capital, the ability and willingness to bear the risks of enterprise, access to secrets of processes in the industry concerned as well as a fair knowledge of the technical know-how, and finally the organising ability.

(1) Joseph J. Spengler, *Economic Factors in the Development of Densely Populated Areas*, *Proceedings of the American Philosophical Society*, Feb., 1951. p. 44.

At the first stages of capitalism, the same person assumed these four functions simultaneously; but following the development of capitalism into big corporations where the functions of risk-bearing and provision of capital are divorced from the organising ability, there has emerged a class of managers and business executives whom Schumpeter has called the innovators, the real entrepreneurs in modern capitalism. It is not our intention here to digress into a theoretical discussion of the theory of entrepreneurship and its functions, or of the related theory of profit whether in its traditional form as a return for risk-bearing or in the Schumpeterian sense as a return for innovation. But it is well to bear in mind that, if a new industry is established or a new product or idea has passed the experimental stage, the promoters of new firms are usually the entrepreneurs from both the traditional and modern viewpoints. Entrepreneurs are necessarily open to the charge that they are profiteering at the expense of the welfare of the country concerned.

2. FOREIGN ENTREPRENEURSHIP.

In under-developed countries, most of the local entrepreneurs specialise in agriculture or in well-established lines of commerce. Very few of them venture to enter into the sphere of industry. In fact they have always shown a tendency to refrain from starting business in other fields of economic activity in which they have no previous experience, and in which the risks of pioneering are enormous. In those countries therefore it is not uncommon that

several other fields of business have been taken up by foreigners, that the bulk of industry, commerce and finance is usually found to be in foreign hands. This is indeed a main feature of business life in Latin America, Africa and the Middle East. But here we cannot overlook the fact that foreign entrepreneurship is often subject to two serious criticisms.

In the first place, there are foreign companies which make and export exorbitant profits in some under-developed areas. Mostly profits are exorbitant because such companies might have secured a monopolistic position and the government concerned has signed away some natural resource or a public utility without demanding an adequate royalty or rental in return. This state of affairs might have taken place through ignorance, or corruption or external political pressure. But it often creates political tension and discontent among the nationals; and, in consequence, foreign entrepreneurs are necessarily open to the charge that they are profiteering at the expense of the welfare of the country concerned. For, not only are profits exorbitant, but they are not even kept within the country. In most cases these exorbitant profits leak out of the domestic income stream and are exported abroad. But this is one side to the problem of high business profits. On the other side, these may reflect the high marginal productivity of capital that can be realised through an over-all expansion of the domestic market, for some countries, though still backward, are in process of expanding their domestic economy. Even in the absence of

development, however, profits may be high, partly because they may represent rewards of entrepreneurial and managerial services, which are very scarce factors in those countries and command a high price; and partly because they may include illusory inventory profits due to failure to provide for fixed capital replacement, which are so common under inflationary conditions.

In the second place, foreign entrepreneurs most frequently confine themselves to developing primary production, to entering into public utilities or to such agricultural industries as ginning, sugar-refining etc., but not to industry proper. Dr. H.W. Singer of the United Nations Secretariat takes it as the basis for his criticism of the 'traditional' type of foreign investment. He holds that foreign investment was foreign only in a geographical sense. It formed essentially a part of the creditor country's economy, and did little or nothing to promote, and may even have occasionally impeded, the economic development of the debtor countries. This attitude on the part of foreign entrepreneurship has diverted under-developed countries into "types of activity offering less scope for technical progress, internal and external economies taken by themselves, and withheld from the course of their economic history a central factor of dynamic radiation which has revolutionised societies in the industrialised countries."⁽¹⁾

(1) H.W. Singer, The Distribution of Gains Between Investing and Borrowing Countries, American Economic Review, Papers and Proceedings, May, 1950.

Nurkse, however, is disposed to look upon these generalisations as little too sweeping. In his view, they seem to apply only to a minor part of international investment in the century before 1914. We may agree with Nurkse that in the past decades most of the foreign money has gone to developing public utilities, either by loans to governments or by direct investment in railways and electricity business, and that these undertakings are just as necessary to any country whether it is developing primary or secondary industry. These undertakings unquestionably provided a useful foundation for the general development of the borrowing countries. We may agree, too, that even in the case of the so-called 'colonial' type of foreign investment, i.e., foreign-owned extractive industries working for export to the industrial countries, various direct and indirect benefits were likely to develop, contributing gradually to the growth of the local economy. Still, the fact remains that, on the whole, 'direct' foreign entrepreneurial investment, as distinct from 'portfolio' investment in under-developed countries has shown a preference for activities connected with exports of primary products to advanced countries and an aversion from activities catering for the domestic markets of the debtor countries. Is there an explanation for this fact?

True, the general reluctance of private business capital to go to work for the domestic markets in the less developed countries, in contrast with its eagerness in the past to work there for export to the industrial creditor countries, does not reflect any

sinister conspiracy or deliberate policy; still less any concerted attempt of the rich countries to exploit the poor. Exploitation there may have been, but this pattern of foreign investment by itself does not constitute any proof of it. This pattern, Nurkse points out, can be readily accounted for on obvious economic grounds. The explanation lies, on the one hand, in the poverty of the local consumers in the under-developed countries, and on the other, in the large and vigorously expanding markets for primary products in the world's industrial centres during the nineteenth century.⁽¹⁾

In these circumstances it was natural for foreign business investment to serve merely as projections of the industrial creditor countries for the purpose of meeting the needs of these countries through cheap foodstuff and raw materials. In other words, the incentive to invest was created by the investing countries' own demand for the primary commodities which they required. There never was much inducement for foreign business capital to go to economically backward areas to work for the local markets there. These markets were too small to provide an incentive. Private investment generally is governed by the pull of market demand, and international investment on private business account is no exception to this. The weakness of the market incentive for private investment in the domestic economy of low-income countries can affect domestic as well as foreign capital. Even if we abstract from political and other risk factors inherent in

(1) Ragnar Nurkse, *op. cit.*, p. 25.

international investment, there is no guarantee that the motives that animate the individual business man will automatically set in motion a flow of funds from the rich to the poor countries. The doctrine of balanced growth reveals limits to the role of direct business investment. A private investor may not have the power, even if he had the will, to break the deadlock caused by low productivity, lack of real buying power and deficient investment incentives in the domestic economy of a backward area. It is the size of the local market that explains why American direct investments in manufacturing industries abroad have gone mostly to Western Europe and Canada where industry has already been highly developed, and why they have tended to keep away from the industrially backward countries.⁽¹⁾

All this of course applies to direct foreign entrepreneurial investment which must be classed predominantly as a form of 'induced' investment, since it generally has to be induced by tangible market demand already existing or visibly coming into existence. By contrast, capital outlay by public authorities financed from private, or public, foreign funds can be called 'autonomous' investment, since it does not depend closely, if at all, on the state of market demand. Thus the general distinction between autonomous and induced investment, which has become familiar in business cycle literature, seems to be applicable in a certain sense to the case of international investment as well,

(1) Ibid. pp. 25-28.

though here as in business cycle theory the distinction is not absolute, but is essentially a matter of degree.⁽¹⁾

Of course, no problem of high profitability or economic exploitation of borrowing countries arises if foreign entrepreneurship can be done away with, if domestic capital rather than capital imported from abroad, in one form or another, will set in motion a process of development on all fronts, i.e., a balanced growth of the national economy. In other words, no problem arises if domestic entrepreneurship is not in short supply. However, the important service which foreign entrepreneurs render the capital-importing countries is not so much the immediate increases in their national incomes. It is rather the fact that these foreign entrepreneurs prime the pump of industry, create industrial momentum, so to speak, from a humble beginning to great achievements in the end. They get the whole thing started, and nationals learn the technical as well as the managerial know-how; and perhaps they dispense with foreign assistance at later stages of development. Foreigners are usually expected to give the local people the opportunity to acquire the experience needed in industry. But where the activities are largely in the hands of foreigners of different race, it is not uncommon for the local people to be denied employment in the higher ranks.

Needless to say, the business of training potential domestic entrepreneurs is most important in economic development, and for

(1) Ibid., p. 29.

the sake of increasing their numbers, governments of under-developed countries can do a great deal by appropriate legislation in order to facilitate the employment of local people in the higher ranks of foreign corporations,⁽¹⁾ and by sending young people abroad to work in foreign businesses for the purpose of acquiring managerial techniques. Germany and Japan are well-known examples of this. But special difficulties, it will be observed, stand in the way of coloured people finding such employment in white countries, and special assistance might be given for this purpose by the technical assistance agencies. The training of business managers is indeed of the highest importance. In many industries, in many countries, output could be increased very substantially with the same equipment and the same labour force, if only more efficient managers were available.⁽²⁾

(1) In Egypt, for instance, the three year period of grace by the end of which foreign firms were required to have complied with the provisions of the Company Law No. 138 of 1947 came to an end on 4th November, 1950. On the whole, firms have succeeded either in complying with these provisions (of which article 5 dealing with the percentage of Egyptians to be employed proved to be the most difficult), or at least in satisfying the Egyptian authorities that they had made a reasonable attempt to do so. In these latter cases the authorities have generally taken a sympathetic view and have been prepared, in many instances, to extend the period of grace provided that firms could show that Egyptians were receiving training to enable them eventually to take positions now held by foreigners and that the required percentages could be reached within a reasonable further period. A certain degree of lenience has also been shown in giving exemption from the terms of this law to a number of experts who could almost certainly not be replaced for some time by Egyptians.

(2) United Nations Report, op. cit. Sec. 93, p.33.

3. THE ELEMENT OF RISK.

But even if the governments concerned have embarked on large-scale schemes for training prospective entrepreneurs at home and abroad, it is most likely that entrepreneurship in under-developed countries will remain a scarce factor of production, at least at the early stages of economic development. That is so because three difficult obstacles normally stand in the way of entrepreneurial initiative: the element of risk, the time factor in respect of economies of scale, and the inconsistency of money wages of labour with its real costs.

The element of risk is not confined to economically backward countries. It is inherent in business enterprise everywhere at all stages of development. In this respect the difference between more advanced and less advanced countries is that in the one case business risks are those ordinary risks of enterprise as the result of uncertainties in the free competitive system, whereas in the other both risks of enterprise and transfer risks usually obtain as long as the foreign element plays an important part in the development of the local national economy.

In more advanced countries devices have been made with a view to keeping down the ordinary risks of enterprise. In those countries patent laws have been promulgated for this purpose.⁽¹⁾ This is the reason why Schumpeter seems to favour a patent system

(1) For detailed study of the patent system in relation to economic development see Chapter 19, Sec. 2, below.

as a potent stimulant to the innovating spirit and entrepreneurial initiative. By implication he tacitly assumes that monopoly enhanced by the protective device of patents is better than free competition without a patent system.

But apart from this aspect of risk-bearing which is obviously common to both developed and under-developed countries, what is relevant here is to consider the specific ways which the governments of the latter countries may devise with a view to warding off the impact of the element of risk on prospective entrepreneurs. First, there may be created local monopoly by setting up tariff barriers, or by adopting a policy of long-term contracts. For most people are reluctant to enter into a new business or venture unless they can see a future in it. Tariffs would mean to them a guaranteed price which is not subject to severe deterioration as a result of foreign competition. It is when attempts are being made to produce, or increase the production of, commodities with which the country concerned is by no means familiar, that the guaranteed price makes a tremendous difference in business. To illustrate:

"An important exception to the laissez-faire philosophy recognises the fact that an industry is not at its strongest until it has attained a certain size and experience. Hence, if protection were ruled out, often the country that started an industry would be able, by competing abroad, to prevent other countries from following in its footsteps, and might succeed in making substantial profits

at their expense although, if once their industries were able to get past their teething troubles, they would be quite as efficient as that of the country first in the field. This infant industry argument is now seen to have very wide implications. For what is true of one industry is even more true of industrialisation as a whole. Countries predominantly agricultural are at a disadvantage when they start to industrialise, in competition with the older industrial countries. But, given a stage of protection, they may in due course be perfectly capable of holding their own."⁽¹⁾

The same is true of bulk contracts which have been common in the last few years as between countries or as between the United Kingdom and its colonies. It is not only the question of favourable prices that matters in such bulk purchases, but even if prices under bulk contracts are such that over the average of years they are more or less equal to free prices, the main advantage to the entrepreneur is increased stability, a guaranteed market and the mitigation of the uncertainties of future demand. "There are, for example, many colonies," says Lewis, "which will start to grow tobacco, or groundnuts, or sugar, if they are guaranteed a market, but not otherwise. This does not apply to all commodities. If the local merchants know the crop, are willing to handle it, and know that they can always dispose of their purchases on an organised market, supplies may flow easily in response to favourable prices. But there are many cases where a

(1) W.A. Lewis, *The Principles of Economic Planning*, pp. 62-63.

firm contract will make just the difference to the undertaking of a new venture. Accordingly, whatever may be the fate of bulk buying in general, it is important that government agents should be free to make such contracts in particular places where they are trying to expand supplies."⁽¹⁾

Another way of frustrating risks of entrepreneurship is the popular method of tax reliefs or exemptions. During the first five or ten years of their life, the newly established firms in a new industry are to be granted certain tax concessions. This fiscal measure, however, may not prove in practice to be very great if the tax concession ranges, say, between 3 to 4 per cent of the cost price of the product. Prospective entrepreneurs may not consider this insignificant reduction in the cost of production as a great thing. Besides, if foreign capitalists do enjoy, from the outset, double taxation exemption, as is sometimes the case, such an exemption will be of no real value as a stimulant to foreign entrepreneurial initiative. It is only when no previous measures for double taxation exemption have been taken that foreign entrepreneurs may profit by such a fiscal device.⁽²⁾

(1) W.A. Lewis and others, Attitude to Africa, A Penguin Special, 1951, p.103

(2) Foreigners, considered to be permanently resident in Egypt, are subject to the same taxation as Egyptians, while Egyptian fiscal laws, although territorial in principle, also apply to income derived from Egypt by persons residing abroad: Egyptian income tax is payable on dividends paid by a foreign enterprise not operating in Egypt, if the shareholders are Egyptians or foreigners usually residing in Egypt and the dividends are brought into Egypt. Profits made or dividend paid by a foreign enterprise whose main object is the exploitation of a business in Egypt are like profits made by an Egyptian Company, subject to Egyptian income tax, even if the shareholders are foreigners residing outside the country.

Finally, the government concerned may guarantee a certain rate of profit in some business undertakings whose services or products are of vital importance to the national economy. This is historically observed in the development of transport and the era of the introduction of the railways. During the last century, for instance, the French Government used to guarantee a certain rate of profit to some railway companies.

4. THE TIME FACTOR.

The second stumbling block in the way of entrepreneurial initiative is that new industries take time to become economical. The cost of producing a commodity at home may be a function either of the quantity produced, or of the length of time for which the productive process has been undertaken.

Let us consider the first proposition. Some authors hold the view that many under-developed countries are so small that their internal market is not large enough to support large-scale industries; and they propose as a remedy the creation of preferential tariff systems, customs unions or even political federations among such countries.⁽¹⁾

But the main trouble, however, is not that countries are too small either in terms of the number of the country's inhabitants or in terms of physical area. A country with a large population will have only a small total capacity to produce, if its people

(1) United Nations Report, op.cit., Sec.62, p.23.

have a low productivity per head. Size of population can affect the average level of productivity only in so far as the concept of an "optimum population" is valid. But even if a country with a large population does produce a sizable aggregate output, this still does not mean that it constitutes a coherent market. There is also the cost of transport to be considered; but this factor, too, should not be considered alone. It is true that with given population density and productivity per head, improvements in transport will increase the physical extent as well as the economic size of the market. But physical extent and economic size are not identical, for the latter depends on the efficiency, not only of transportation, but of production in general. True, improvements in transport are important, and transport facilities do play quite an important part in economic development. It is also true that tariff barriers may be regarded as artificial transport costs, and that reductions in transport costs, whether natural or artificial, do produce an increase in the size, as well as in the geographical extent of the market. But reductions in any cost of production, not only in that of transport, have that effect. Any increase in economic efficiency, whether in the efficiency of transportation or of any other items of production costs, increases the size of the market. But to single out transport costs and to speak of the territorial extent of the market as the main or the sole determinant of its size seems to be a case of misplaced emphasis. China is a well known example of this. This country, one of the

poorest in the world, used to have a system of internal customs duties which acted as interregional tariff barriers. In 1928 this system was abolished, and China became, from the point of view of commercial policy, one of the world's largest national markets in area as well as in numbers of people. Yet China remained one of the poorest countries in the world. For the main trouble is not that countries are too small. It is rather that they are too poor to provide markets for local industries. As has been pointed out already, the market difficulty in poor countries can best be understood only in relation to the concept of balanced growth.

Let us now turn to the second proposition that the cost of production is also a function of the length of time for which the productive process has been undertaken, i.e., the time factor in respect of economies of scale. In discussion of this problem, the 'infant industry' is a phrase that crops up frequently in economic literature. The infant industry or young economy argument has been recognised for well over a century. The idea is associated with the name of the nineteenth century German economist, Friedrich List,⁽¹⁾ and it has received the cautious blessing of John Stuart Mill, Alfred Marshall, Frank W. Taussig, and other orthodox economists. According to this doctrine, there are many lines of activity in which a country would really have a comparative advantage, if only it could get them started. If faced with

(1) C.f. Part I, Chapter 2, 'The Theory of Economic Policy in Classical Political Economy', Sec.1, pp.70 - 73

foreign competition, infant industries are not able to weather the initial period of experimentation and financial stress. But given a breathing space, they can be expected to develop economies of mass production and the technological efficiency typical of many modern processes. Although protection will at first raise prices to the consumer; once the industry grows up, it will be so efficient that costs and prices will actually have fallen.

In developed countries, the only thing to do about a new industry is to integrate it into the industrial framework. In backward countries, however, labour should learn the mechanical work in general, beginning from scratch for the whole range of this type of work. The culture is quite different, and it would be extremely inefficient if a start is taken in factories with operatives who have no mechanical outlook. Moreover, the factory life necessitates a different social norm of behaviour. Social relationships and values have to be changed, and mentalities diverted from agricultural to industrial atmosphere. This new tempo of life will take time, perhaps a long time indeed. That is the very reason why the Industrial Revolution started to be based on juvenile employment, for juveniles are more easily adaptable to the new environment. On the contrary, it would take adults one or two generations to get their cultures changed as a result of changes in productive methods. For these and other reasons, the cost of a new infant industry will be high at the outset. Internal economies will arise only as time goes on.

Economies, however, are not only internal; external economies, not in the market sense as defined above, but in the well-known Marshallian sense, are no less significant to the problem of efficiency. In addition to the internal economies which may arise within a certain firm as a result of the expansion of the size of plant, or the intensity of the use of capital, or the greater efficiency of labour, there may also be economies external to each firm in an industry. On the case of 'external economies' is based the concept of the industrial centre, or, as it is sometimes called, the trading estate. Again this concept has special significance to backward areas. Some manufacturing industries flourish with difficulty in isolation. Because of their mutual dependence, they use common services and productive facilities such as power, transport, communications, labour skills and techniques; and they also buy each other's products and by-products. The industrial system is indeed a complicated network, and it has to be created anyway. Hence if an industrial centre is to be started from scratch, it may be desirable to arrange for as many complementary industries as possible to be started at about the same time in the same place. "The initiative in making and executing a plan which has the effect of bringing many private entrepreneurs together in this way must usually rest upon the government, and is an important function of an industrial development corporation."⁽¹⁾

(1) United Nations Report, op.cit., Sec.59, p.22.

(1) For detailed view

This technique of development is known to be of common use in many countries. In the United Kingdom, the trading estates came into being after the building up of the Manchester Canal. Factories were built in the planned estates, and facilities of all kinds were provided on a large scale from the first beginning.⁽¹⁾ So also was the case with Russian economic development. Industrial areas were planned once and for all, and external economies for the whole industry could be achieved with no regard to the element of time. In Japan the lead was taken a century ago after the Sino-Japanese war. Even in Latin America, development corporations were created for industrial development. The governments concerned were on the look-out for industrialists to settle down in the trading estates, providing them with all facilities: money, factory space, recruited labour and such. There is no reason why this useful technique should not be adopted in under developed countries, following the same pattern of industrial development in many more advanced countries.

5. INCONSISTENCY OF MONEY WAGES WITH REAL COSTS OF LABOUR.

The third obstacle in the way of entrepreneurial initiative is the problem that money wages are not usually the true measure of the real costs of labour in under-developed countries. At first sight it might be expected that, once more modern productive techniques have been adopted in the field of industry, the physical productivity of labour must immediately rise by leaps and bounds. This is a

(1) For detailed study see D.G. Wolton, 'Trading Estates'.

mistaken view. At the initial stages of industrial development, it will be observed, labour in under-developed countries is usually unfamiliar with modern techniques of production. Wastage of materials, friction, accidents, frequent absenteeism, lack of discipline, lack of training, lack of interest in one's job, indolence, carelessness and dullness of mind as a heritage from the agrarian mode of life, all combine to render the physical productivity of labour relatively very low. Meanwhile, money wages which manufacturers are required to pay are often above the marginal productivity of labour; for the determination of wages in backward countries seems to be an arbitrary matter, perhaps in consonance with the conventional levels of subsistence.

Unless something were to be done to establish consistency between money wages and productivity of labour, very little would be achieved in creating entrepreneurial initiative. There may be a way out to cope with this anomaly: it is to grant subsidies to industrial production, or to depreciate the national currency, or else to cut off local prices from world prices by way of tariff barriers.

It is noteworthy, in this connection, that all the literature written by economists on the subject has laid much emphasis on protection as the most potent weapon to promote industrialisation. In fact no country in the world has ever become industrialised without certain protective measures. It was only as late as the nineteenth century that England reversed her commercial policy

from protection to free trade, but prior to that period, protection was indeed an effective technique of industrial development in this country.

But protection will not in itself solve the problem of industrialisation. To solve it, an under developed country must spare no efforts to get hold of entrepreneurial skill, capital resources and a new generation of skilled labour, and must see to it that a network of complementary industries is well established, ensuring a balanced growth of the national economy and creating efficiency over the whole field of economic activity. Industrialisation is a costly business. It is achieved not so much by keeping the level of domestic prices above the level of world prices by way of tariff barriers as by bringing the level of domestic prices down by way of increased economic efficiency and expanding markets.

Consider, for instance, the case of industrial development in Egypt as an example of this. The great activity which reigned during the immediate post-war years in the establishment of new industries and the consolidation and extension of existing ones has now to a considerable extent subsided and it may well be that, with the possible exception of iron and steel production, most of the main industries capable in present circumstances of development in the country are now well covered. Very few new manufacturing companies have been constituted in the past few years and whilst this may be due to some extent to the shyness of capital from

outside Egypt to invest in new enterprises in view of the Company Law (1) regulations, the difficulties which many local industries have to face in meeting foreign competition may well also have played a part. Although labour in Egypt is still comparatively cheap by European standards, the overall cost of production, owing to a variety of factors such as small output, higher cost of raw materials (since most must be imported), less skilled operatives, etc., is in many cases much greater. Consequently prices of local industrial products often tend to be higher than those of similar imported goods, in spite of the relatively high customs duties levied on the latter.

6. ENTREPRENEURIAL EFFICIENCY.

It is now time to consider the problem of entrepreneurship, not from the quantitative, but from the qualitative, point of view. Needless to say, the quality of entrepreneurs, in addition to their number, is equally essential to any programme of economic development. This should bring us to an important question: how can improvements in the quality of entrepreneurs be achieved in an under-developed country?

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- (1) Article 6 of the Company Law No.138 of 1947 stipulates that 51 per cent of the shares of all new limited companies must be made available to Egyptians. This article has come under severe attack throughout its life, not least from Egyptian leaders of finance and industry. It has been well recognised that Egypt must have capital and knowledge from abroad if its industries are to be developed and that the effect of the Law has been to drive both away. For all practical purposes since the passage of the law no foreign capital from sources outside Egypt has been invested in the country.

Let us first consider the traditional assumption of the classical economists who believe that competition alone is the key to increased efficiency. Inefficient business men are driven out of industry by the ruthlessness of the competitive market. This is but the application of the principle of the survival of the fittest in the sphere of business. But this classical assumption has been attacked from different quarters.

The first attack comes from the Marxist quarter. The Marxians contend that if competition is maintained all the time, well and good. But the historical evolution of capitalism points to the fact that competition fades away into monopolistic organisations of one form or another. It exists only in the minds of the classical economists, but not in the world of reality. By implication reliance should not be placed on the competitive drive as an incentive to economic efficiency simply because it is only an imaginary state of business conduct. The second attack comes from the Schumpeterian quarter. For the essence of Schumpeter's theory of economic development, as referred to above, is that the entrepreneur in the modern sense is, not the routine manager, but the innovator or initiator of new ideas and new ways of doing things. Innovations, however, should be monopolised at least for a certain period of time. In this sense monopoly thus becomes the sum and substance of the modern concept of entrepreneurship.

This sort of controversy will be dealt with later on in its proper context. Here it is only proposed to proceed with the analysis

of the so-called gospel of high wages as a means of enhancing industrial efficiency in under-developed countries. One line of argument is to squeeze profit margins by raising wages and freezing prices. It is contended that this pricing policy would compel entrepreneurs to try to squeeze costs of production in order to get back their pre-existing levels of profit. This gospel of high wages, it is urged, is indeed the secret of progress.

But the case is not so simple as this. If profits were squeezed for the purpose of increasing efficiency, profit incentives would of course diminish; and foreign capital, which is so urgently needed in any under-developed country, would be withdrawn in whole or at least in part. If, on the other hand, foreign capital were not withdrawn and entrepreneurs had to search for more efficient methods of production and techniques of organisation, this would naturally involve the achievement of a higher level of capital investment and the introduction of more elaborate machinery. Surely this would in no way assist most of the under-developed countries, since they have a surplus of labour to begin with. In those countries the gospel of high wages is thus no remedy to the problem of entrepreneurial efficiency. If high wages are to have any effect on economic development, this must come through increased productivity of labour. This is a highly desirable goal in the development process.

The gospel of high wages, however, implies another line of argument. It is that wages have to be pushed up whilst prices

have to be pushed down. This line of argument is apparently based on the theory of prices: a reduction in prices of wage goods tends to bring about an expansion of prospective demand which is then translated into effective demand, if the price reduction is coupled with an increase in money wages. In turn an expansion of demand for wage goods then gives rise to a corresponding expansion of capital goods' industries through the effect of our old friend, the Acceleration Principle that establishes the relation between investment incentives and market demand. Profit per unit of output may flag; yes, but not necessarily the total profits. And, even if total profits were levelled down to some extent, this would be a potent stimulant to entrepreneurial efficiency.

Evidently this line of argument tacitly implies that any increase in money incomes of the wage-earners would be spent on wage goods, and would therefore increase market demand. We know, however, that so many budgetary investigations have been made of the ways in which people at different levels of income spend their money; and there is remarkable agreement as to the general, qualitative patterns of behaviour which have sometimes been called Engel's Laws, after the nineteenth-century Prussian statistician who first enunciated them. What concerns us here in these behaviour patterns is, of course, the poorest income class which covers the majority of wage-earners. These patterns reveal that poor families must, of course, spend their incomes largely on the necessities of life: food, shelter, and in lesser degree, clothing.

As income increases, expenditure on many food items goes up. People eat more and better, shifting their consumption from the cheap and bulky to the more expensive foodstuffs. However, there are limits to the amount of extra money that people will spend on food when their incomes rise. Consequently, the percentage importance of food expenditure declines as income increases; and there are even some few cheap items, the so-called 'inferior goods', whose consumption decreases absolutely with income. After the individual gets out of the very poorest income class, the proportion of income he spends on shelter is pretty constant for a wide range; while expenditure on clothing and other amenities of life increases more than in proportion to income, until the very high incomes are reached. Hence it sounds reasonable to suggest that, by and large, income elasticity of demand for wage goods is relatively low.

But all this analysis is only part of the story. In under-developed countries, there seems to be another relevant factor which must be given its due weight. In those countries it is not only that the level of wages is too low to be comparable to the level of wages in industrial countries, but the workers there seem to be content with their consumption standards either through lack of education, or through ignorance of better living standards, or through lack of interest in material welfare, so much so that it is rather difficult to change their consumption habits. Income elasticity of demand for wage goods in those countries is indeed

very much lower than it is in advanced countries, not only because of the relatively very low incomes of the wage-earners, but because of the conspicuous rigidity of consumption habits.

It then follows that both price elasticities and income elasticities of demand for wage goods would most probably be too low to bring about an expansion of market demand adequate enough to compensate for the fall in profit per unit of output. Such a situation is more or less identical with what has been revealed by the previous analysis of the policy of high wages along the former line of argument. In other words, profits would then be squeezed and profit incentives diminished to such an extent that foreign capital would be withdrawn, or else all entrepreneurs, local and foreign alike, would seek to reduce costs of production in order to get back their pre-existing levels of profit by means of more efficient methods of production which would render the labour problem more acute. Both courses of action are socially undesirable from the point of view of the under-developed country at the early stages of planned development, when the supply of labour is overabundant.

Shall we then take a dim view of the prospects of economic efficiency in the under-developed economy? Can we envisage some other ways of solving the problem? Certainly there are a number of cases which are covered by the principle that the government of the under-developed country must sometimes compel all the firms in a particular industry to adopt some measure which the majority

desire, in pursuit of higher efficiency in production, but which cannot be brought into effect unless they all participate. In soil conservation, for instance, some measures are useless unless all farmers in the appropriate area are compelled to participate. The same is true of measures for the control of the spread of diseases of plant or livestock, and measures for comparative grading and marking of some agricultural products.

Compulsory standardisation is also required in manufacturing industries. Needless to say, all aspects of standardisation, whether functional or dimensional, have a bearing on industrial efficiency. (1) Functional standardisation includes all standards dealing with fitness for purpose. Standards under this heading are based on composition or performance, and they may mean methods of test or methods of use (codes of practice). Dimensional standardisation seeks to achieve simplification, unification, and interchangeability. The simplified practice means the reduction of variety in sizes, dimensions, and immaterial differences in everyday commodities. It is a well-established fact that advantages of mechanical production in general and of mass production in particular cannot be realised without bulk production of 'standardised' products by the long run of machinery. In many ways, of course, standardisation within the firm is relevant, but this cannot be separated entirely from standardisation within the industry.

(1) L. Rostas: 'Comparative Productivity in British and American Industry', National Institute of Economic and Social Research, Occasional Papers XIII, pp. 61-63.

some To many minds, moreover, the idea of Development Councils for industry seems to be well suited for improving industrial efficiency. This is not a new idea. In the United Kingdom, for instance, its history goes back as far as the First World War. The Joint Industrial Councils were intended to ensure joint action between employers and workers for the development of industry as part of the national life. During the 1930's many industries suffered from excess capacity and became attracted to the idea of protective devices among which was a scheme for cutting down production. This involved limitation of capacity by "rationalisation" implying reduction to be carried out by a controlled process rather than by relying on bankruptcy and penalising the inefficient by the competitive drive. During the second World War the idea of self-government for industry, though in the background, was never dropped. Some earlier Reports by a series of Working Parties provided inspiration for the Industrial Organisation and Development Act which became law in 1947. The main functions of the proposed Development Councils are laid down in the Law thus: research into processes and materials and design, marketing and standardisation, training, recruiting and working conditions. (1)

It is early to judge the outcome of the application of such novel technique of development. Employers, however, seem to dislike the whole idea, for it carries with it an undesirable taste of government interference and restriction of liberty. Moreover,

(1) For detailed study see P.E.P. publication on Development Councils.

some critics argue against the general principle on the grounds that the idea may bring in its train the emergence of monopoly; or, if its elements are pre-existing, may strengthen monopolistic combination. These critics seem to be impressed by J.S. Mill's statement that "wherever competition is not, monopoly is; and that monopoly, in all its forms, is the taxation of the industrious for the support of indolence, if not of plunder."⁽¹⁾

Broadly the whole discussion of the efficiency problem reveals one fact: it is that we have before us two opposing views on the solution of the problem. On the one side, some critics seem to go along with the traditional school of thought and still believe that competition, if maintained, will drive out the weak and penalise the inefficient. On the other side, some economists seem to favour monopoly and protection as a potent stimulant to the innovating spirit and entrepreneurial initiative. What is then the right policy to adopt? In what follows the problem of efficiency within the framework of economic organisation will be considered in some detail.

(1) J.S. Mill, Principles of Political Economy, Book IV, Chapter VII, p.792.

CHAPTER 19

ENTREPRENEURIAL INCENTIVES
THE EFFICIENCY PROBLEM

"Instead of looking upon competition as the baneful and anti-social principle which it is held to be by the generality of Socialists, I conceive that, even in the present state of society and industry, every restriction of it is an evil and every extension of it, even if for a time injuriously affecting some class of labourers, is always an ultimate good." J.S. Mill.

1. THE MEANING OF A COMPETITIVE POLICY

The competitive system which the state must attempt to maintain is not that type of perfect competition that exists in the minds of economic theorists, but rather the competitive element of a mixed economy which is characterised by a great deal of state control with differences in power of business units, substantial obstacles hindering access to markets, monopolised activities under public sanction and various types of agreed practices.

Competition necessarily takes the form of certain rules of the game established by law and custom. They establish a code of commercial intercourse and business relations, and are designed, in general, to direct competitive behaviour into

desirable channels without reducing intensity of competition. There are, however, other existing rules where their effect is not merely to prescribe forms of behaviour but also to thwart competition that remains permissible, e.g. trade marks, patents, collective bargaining, and natural or technical monopolies.

The existence of such exceptions are inevitable, not only in the case of the so called "natural" monopolies in which peculiar technological conditions make competition inadequate, but also in fields where competition is inevitably one-sided and hence unduly severe in its effects on one side of the market. But C.D. Edwards maintains that even exceptions that are improvidently made need not seriously injure the effectiveness of the competitive policy so long as they are not numerous. (1)

Thus we can only envisage such a competitive policy as resists exceptions to competitive behaviour as far as possible, demands that the need for each exception is essential, and keeps the total number of these exceptions small.

Perfect competition, in the eyes of classical theorists, is but an autonomous device for the reconciliation of private with public interest on the tacit assumption that all persons concerned are perfectly rational and well informed and that

(1) c.f. C.D. Edwards: 'Maintaining Competition'.

they can transfer their purchases and productive energies from one commodity or one market to another without any difficulty. Obstacles in the way of the competitive process are assumed only to delay the smooth working out of the process; but in the longer run perfect competition supposedly results in the best allocation of resources, the maximum aggregate output, and the reward of all productive services is based only upon their productivity. In short, perfect competition is assumed by the classical theorists to be the necessary condition for the achievement of an 'optimum' situation in respect of production, exchange and distribution.

In real life, however, numerous deterrents to perfect competition crop up in such a way that even in the long run this nice and neat picture would not obtain. Information is incomplete and decisions are unwise and confused. Success is derived from competitive selling efforts which may be wasteful, and from differentiation of products which disables the buyer from comparing quality and price. Profit is sought in variety of financial manipulations which have little connection with the productive or distributive process. Firms cease to compete impersonally as their number becomes fewer and their size larger relative to the size of the market. They coerce each other by unfair devices of competition and perhaps they end this personal competition by collusive combinations with an incentive

to limit production and maintain prices above the level reached by the interplay of supply and demand in the open market. Such obstacles prevent competition from achieving its good results. Some critics even go so far as to recognise that competition alone is not sufficient to keep production and employment at high level, to secure the best allocation of resources, or to establish productivity as basis for the incomes of productive services.

The competitive policy assumes, however, that although the maintenance of competition will not guarantee that the economy will work well, impairing competition by monopolistic restrictions, public or private, will increase the chance that it works badly. The competitive policy presupposes that unchecked private power will ordinarily be used to bring about exploitation and restriction of output. It strikes at extreme departures from competition and does not necessarily aim at an atomistic competition envisaged in economic text-books. Thus the direct purpose of any competitive policy is to curb business agreements and accretions of monopoly power which directly limit the productivity of industry or make industrial bargains one-sided. Thus conceived, competition is not a complete basis for public policy. It does not ensure the best allocation of resources, distributive justice, or economic stability in contrast to swings of the business cycle. With reference to all such

problems, it is to prevent defects of economic organisation from being made worse by deliberate adoption of restrictive policies designed to serve private interests. It eliminates extremes of inefficiency and minimises planned restrictions of output, deliberate exploitation of the weak and deliberate refusal to adapt new methods and techniques. These are the limits of its usefulness and to accomplish these purposes, competitive policy is an appropriate part of any public policy.

To what extent, then, is such a competitive policy appropriate for an under-developed country? That is to say, apart from permitting such rules of the game as trade marks, patents, collective bargaining and technical monopolies, is it always desirable to strike at all other forms of business agreements and accretions of monopoly power?

To begin with, the problem of efficiency in the use of labour by private enterprise is one that faces all governments of under-developed countries. However, in countries where labour is abundant and underemployment rife, this problem is of secondary importance as compared with creating new employment opportunities. But, as labour becomes scarce, economic progress depends upon more efficient use of manpower. Efficiency is a function of the use of more capital, the use of better techniques, the pressure put upon entrepreneurs by competitive forces or trade unions or government action, the size of the market, and finally the number and size of business units whether in industry or

agriculture.

Given the scope of the market, the number of firms may be too large or too small for efficiency. In large markets of well-developed countries, it is often possible to leave the solution of such a problem to the ordinary operation of competitive forces. But in the less efficiently working markets of under-developed countries, reliance should not altogether be placed upon the price mechanism. It is therefore necessary to adopt measures either to promote more competition, or to reduce competition, as the case may be, with a view to either increasing or reducing the number of operating units. The success of such a policy seems to depend upon the ability of the government concerned to persuade industrialists to get together and co-ordinate their activities, and also to control their activities if they show a tendency to exercise a monopoly or quasi-monopoly power at the cost of the public.

However, where the structure of industry or agriculture is characterised by many small units of operation, the government can assist in increasing their efficiency by providing services which the small units of operation can use in common. In agriculture, the government can organise educational services, credit facilities, processing and marketing facilities etc. In manufacturing industry, it can similarly organise training facilities, market research, or managerial advice. In the

mining industry, it can assist small units by organising finance, assaying, the crushing of ores, marketing or other facilities.

In under-developed societies therefore monopoly presents a problem. Monopoly is a necessary instrument of economic development in situations where risks can only be taken on the basis of a franchise. Monopoly is also an instrument of efficiency if the scale of operations needs to be large, or if the firms in the industry concerned need to have their activities co-ordinated directly by agreement rather than indirectly by competition. On the other hand, monopoly concentrates economic power, and some communities may prefer greater decentralisation of power even at the cost of lower economic efficiency.

2. THE PATENT SYSTEM and ECONOMIC DEVELOPMENT

Closely related to the major problem of monopoly is the patent system whereby the government excludes potential competitors from the use of technological facilities through the operations of the patent laws. A patent is but a monopoly right to make some product or use some process or design, which has been granted by the patent laws for a limited period of time as a reward for inventive ability. The nature and reward of the grant differ from one country to another. In U.S.A., for instance, the patent holder has exclusive rights to the invention for

17 years from the date of the patent. During this period of time, the patent holder may prevent others from using it or may grant rights of use subject to various restrictions and limitations, regardless of whether he uses the invention himself or not. (1)

Two arguments may be put forward in support of patent rights. First, the theory upon which a patent law is based is that the prospects of monopoly rights will stimulate an active process of invention and will induce inventors to disclose, in application for patents, the substance of their invention. Monopoly rights granted under patents, it is argued, are no disadvantage to the public, for in the absence of a patent system, the monopolised inventions would not have been made or disclosed. In fostering inventions and releasing them for competitive use after a certain period of time, the patent system converts the attractiveness of monopoly into a stimulus for technical improvement and effective competition.

Another argument for the patent system is that the process of perfecting an invention and learning how to put it into commercial use is almost always a slow and expensive one. It is therefore contended that unless an invention is patented, no entrepreneur will be desirous of undertaking such development simply because his rivals in the industry concerned can adopt the perfected technique without incurring equivalent expenses and

can then force down prices in competition so far as to prevent the pioneering entrepreneur from recovering costs of development. According to this argument, therefore, technical progress would be retarded by the absence of patent monopolies, even if there were no diminution in the amount of invention and disclosure. (1)

However, arguments against the patent system are so strong that it is quite relevant to discuss them in some detail before any attempt can be made to formulate a concrete policy towards patent rights.

Legal Power: Enterprises which are often engaged in acquiring and exploiting patents can afford the services of highly skilled patent lawyers who would exercise their skill in inventing formulae of words that plausibly extend the scope of claims made in the application. In this way the patent system may become a device through which the skill of lawyers can be rewarded by grants of monopolies running appreciably further than would be necessary to recognise contributions of inventors. Wherever such a patent claim is granted, the effect is either to transfer into private ownership some part of the public technical domain, or else to anticipate invention by giving someone a monopoly right to inventions that have been verbally described but not yet actually made.

(1) For detailed study see the important article by Professor Sir Arnold Plant on The Economic Theory Concerning Patents for Inventions (Economica, Feb., 1934, p. 30 seq.)

Economic Power: Legal power which may be attached to a patent is sometimes supplemented by economic power derived from the possession of technical trade secrets with reference to the subject matter of the patent. Theoretically a patent is granted as an inducement for the inventor to disclose his invention. When a patented product is sold, its nature is necessarily disclosed in the sale; but this is not true of a patented productive process. It is possible to obtain a process patent without revealing all that must be known in order to make an effective use of the patented invention.

Where this is done, the public will not receive the information that is supposed to justify the grant of monopoly rights to the inventor. Instead, the patentee obtains the bargaining power attached to a legal monopoly and continues to enjoy bargaining strength derived from the possession of a trade secret. This trade secret is generally regarded as a property distinct from the patent to which it is applied.

Risk of Stagnation: Although a patent grants a monopoly, monopoly power conveyed by a patent may not be large. The so-called 'basic patents', which are indispensable for those who would engage in some type of production, may convey a monopoly of an industry. In most cases, however, a single patent covers only an improvement in industrial technique, or one of several alternative devices by which a technical objective can be reached. So long as other enterprises can develop alternative

patents, the holder of such a patent has little power to translate it into control of an industry; thus the danger is less one of monopoly than economic stagnation. From the point of view of public interest, the chief risk is that complementary industrial techniques will be patented by different interests and will not be used because the various patentees are unable to agree upon the joint use of their various inventions.

Suppression of Patents: When a large number of patents are held by the same concern, the situation is different. Having acquired one patent that covers one way of achieving a given result, the enterprise would attempt to acquire all other patents that cover the other ways whereby the same result may be achieved. But once these patents are assembled, only the best is used; the rest being retained in order to exclude competitors from the industry concerned by preventing them from using alternative processes. Besides, as large numbers of patents are assembled, the holder thus exercises control over many complementary improvements in the industry's products and processes. Though the patents may be individually of minor importance, in the aggregate they give control of the industry so much that competitors are denied access. Patent control therefore ceases to be the monopolising of a particular advantage in a product or in an industrial process; instead it becomes to be a substantial monopolising of the industry itself.

Ineffectiveness of Time Limitation: A business enterprise that bases its strategy upon patents is always concerned to buy

up new patent rights as its old patent is due to expire. It endeavours to avoid a situation in which it no longer enjoys patent protection. If the enterprise is fortunate enough to control basic patents without which competitors cannot operate, it may control the industry for 17 years. And, since technology is dynamic, the patentee is likely to acquire important new patents within the 17 years period and to use them in order to perpetuate its exclusive position or limitation upon its competitors. True, there are cases in which basic patents of an industry expired and the patent control was broken. It is also true that there are cases in which important new patents have been developed by enterprises other than those that held the old ones, so that patent control has passed from one enterprise to another. But equally true, however, there are cases in which one enterprise has held control through patents for several decades.

Domination of Industry During the Patent Period: Besides the expiration of patent control has not always meant the expiration of the monopoly which was originally based upon patents. During the period of patent control an enterprise that dominates an industry may establish its trade marks, develop its marketing channels, purchase most of the available reserves of raw materials, make long-term contracts with important customers and distributors, and in various other ways

consolidate its dominant position.

Thus where the strength of a patent position is great enough to give one enterprise monopoly control over an industry, exploitation of the monopoly is similar to that of monopolies which have other origins: limitation of output, high prices and high profits. The only difference is that in the patent monopoly there is usually an active inventive process designed to perpetuate patent control and also an active process in buying up patents developed by others. Thus technological progress and efficiency is likely to be more rapid than under other forms of monopoly; but the rate at which the new technology is put into commercial use may be less rapid than the rate of invention.

Thus conceived, a competitive policy calls for measures to prevent the use of patents as devices whereby industries may be controlled through patent rights. This would require modification of the structure of existing patent laws and procedures. This is to be determined not only by considerations of competitive policy, but also by decisions as to incentives that are appropriate to conduct, disclosure and use of research. If patent monopolies are not needed as incentives, the abolition of the patent system is the easiest way to solve the problem. If, however, patent rights are to be considered as desirable aids to technical progress, then changes in the patent

system will be necessary so long as that system is to be kept consistent with competitive policy.

A major part of technical progress today is the result of systematic co-operative research in which a research worker builds upon the activities of his fellows. Thus the result of this type of research cannot conveniently be attributed to particular individuals or even to particular research institutes. If a flash of genius still continues, it is argued, there is no need to be rewarded by monopoly. Systematic research is expensive; there is thus the need to maintain patent rights in results of research as incentive to incur research expenditure. If such a standard were adopted, grant of control over new technical devices would not be based upon the novelty of invention but upon the proof that systematic and expensive research activity has taken place.

Another patent reform should be to prevent patentees from unreasonably keeping their inventions out of use. A further reform is the prevention of a licensing policy that blocks the development and use of patents held by others. Patent laws of some countries attack the problem by authorising any patentee to obtain a licence under a patent held by another if he can show that his own patent cannot be made use of without this licence and if he is willing to grant reciprocal licence.

There is also the need to prevent the development and perpetuation of great concentrations of patents which give

enduring monopoly power over a whole industry, e.g. by reducing rights conveyed by patents. Under a system of compulsory licensing, the enterprise with many patents would obtain a large revenue from royalties but they no longer have the power to exclude others from an industry by withholding its technology.

There is again the need to prevent impairment of competition within an industry through monopolistic restrictions incorporated in patent licences. The most direct and effective way is to prevent the patentee from including restrictive provisions in the licence. Under such a system, licences would become only a means to collect revenue from the sale of rights to use an invention and cease to be a means to control the marketing of a product.

If, however, this is the case for and against the patent system, then in what sense is the whole argument relevant to the problem of economic development in under-developed countries?

In those countries the patent system is part and parcel of the major problem of monopoly. If once the encouragement of inventive ability has become a part of public policy, monopoly rights have to be granted under patents.⁽¹⁾ But in laying down new patent laws

(1) Law No. 132 of 1949 is Egypt's first statute law relating to patents and designs. In past years it was the practice, in the absence of a proper Patent Law, for the specifications of inventions and the representations of new designs, to be registered in the Mixed Court of Appeal and during more recent times, in the National Courts. According to the new law, patents for inventions and registrations in respect of designs not coming within the ambit of Article 55 will be granted for terms of 15 years (subject to the payment of renewal fees annually). This term is reduced to 10 years in the case of an invention relating to a chemical process for the production of foodstuffs or medicines. In the case of an invention or design coming within the provisions of Article 55 of the law, i.e. that which has been used or published in Egypt on or before 25th November, 1949, the patent or design registrations will be granted for the unexpired portions of the terms of years indicated, calculated from the dates of filing of the first application lodged in any country for the protection of the inventions or designs concerned.

and formulating a concrete policy towards patent rights, the governments concerned may well take into serious consideration the many abuses of the system in the light of American and Western experience. Besides, entrepreneurs in under-developed countries may take advantage, not only of probable technical progress at home, but also of actual advance of technology overseas, if by mutual agreement they are allowed to produce under a reformed system of compulsory licensing. In other words, a patent policy as such will have both a preventive and a constructive side: preventive, in the sense of avoiding the abuses of the system; constructive, in the sense of encouraging the transmission and appropriation of new foreign inventions.

3. CO-OPERATIVE INDUSTRIAL RESEARCH

All firms are always looking for information which they may turn to account, but its scope and intensity varies considerably from one firm to another. At one extreme, we find firms that satisfy their thirst for knowledge by casual reading. At the other extreme, we find firms that maintain a group of scientists and technologists who keep in close touch with scientific and technical development all over the world and who carry out experimental work in connection with scientific principles, materials, processes and products in which their firms might be interested. This is what is commonly called industrial research.

But between research and production, there is another stage

commonly called development. It is concerned more with exploiting knowledge than with adding to it, and it involves the solution of production problems and the assessment of commercial possibilities and limitations. The development stage requires the co-operation of the scientist, designer, production engineer and the financial expert. It is rather impossible to draw a logically satisfying line of demarcation between industrial research and development, and more often than not the expression industrial research is commonly used to include both.

The potential field for profitable research, it will be observed, varies greatly from industry to industry and from time to time. As R.S. Edwards has pointed out, we can distinguish five different conditions for industry in so far as industrial research is concerned.⁽¹⁾ In an industry newly founded on a major scientific advance, research is likely to justify great expenditure because so much will depend on the race for master patents and for domination of the field or sections of it. In an industry where scientific advance is not so significant, research expenditure may be much less, although great attention may be diverted to scientific research designed to reduce costs, improve products or initiate product differentiation. In an industry which is so suddenly faced with a change in the supply conditions of an important factor of production, a large increase

(1) c.f. R.S. Edwards, 'Co-operative Industrial Research.'

in research expenditure may be of great importance. In an industry where the pace of research has been slow, a change in outside conditions may render an increase in research expenditure immensely profitable and of great necessity for its survival. Thus a firm's research and development are in some measure determined by factors outside its own control and by its industrial environment. But in most industries, in advanced countries, there is a great scope for variations as between firms. Some firms may pursue a policy of keeping abreast with development in the hope of recovering costs of research plus a profit through the partial monopoly that technical leadership would ensure them. Other firms may be content to make a standard product and depend on a low price achieved through good administration to secure them a good business.

But how far is it possible to forecast the yield from research? With respect to a project at the development stage, it is normally possible to make rough estimates of cost and future revenue if the development proves to be successful and goes into production, and on such a basis it seems possible to consider whether the expected cost of development is worth incurring. But in so far as research in the narrower sense of exploration is concerned, it is so much the more difficult to see how there could be a forecast of the yield. In practice, however, some firms in advanced countries allocate a percentage of their

turnover; others a percentage of profits or a lump sum depending on the profit. In some other firms it is actually left to the decision of the head of the research department.

But no government of an under-developed country can ensure that its nationals will make discoveries and inventions, or will transmit the large store of Western technical and scientific knowledge in a way that would lead to improvements in economic efficiency. Governments of under-developed countries can do much to ensure that conditions are conducive to scientific research. They can contribute funds to firms or associations set up by groups of firms. They can finance independent research institutions, if any, as well as universities. They can also set up agricultural and industrial research institutes, staffed by a scientific civil service.

But if the gap in technology between the developed and under-developed countries has grown wider and wider, is there indeed any scope for scientific research in the latter countries? Would it not be that the automatic transmission of Western technology is a ready solution to the technical problem? The answer is that the economic emphasis of experimental work is different in some under-developed countries from what it is in the developed. Large sums of money must be spent on research into the special needs of the former countries. Some of this experimental work can very successfully be done inside the research institutes of developed countries where, indeed,

much of it has been done in the past. But there is needed also a vast multiplication of research institutes inside the under-developed countries themselves.

4. THE TECHNOLOGICAL PROBLEM

IN PERSPECTIVE

What is commonly known as 'technological progress' can mean two things. First, and quite frequently, it refers to the construction of more and better instruments of production and to the utilisation, for this purpose, of a greater share of the existing store of technical knowledge. The store of knowledge may remain unchanged, and yet we may have 'technical progress' in the sense of a greater application and embodiment of it in material objects. The other sense of the term is that in which technical knowledge increases without any change in the form or quantity of capital goods. An advance in technical knowledge in the abstract may be of no economic relevance if there is no capital in which to incorporate it and with which to take advantage of it in the process of production.

We shall here proceed on the assumption that there is a great fund of technical knowledge in the advanced countries which could be applied advantageously to the productive processes in the less developed countries if only the economic resources were available to make use of it. True, the cumulative

character of technical progress, and the traditions and cultural patterns which it brings about, make it easier for the developed countries to achieve a more rapid and continuous advance in technology. But if the obstacles to the absorption of new technology are overcome, the existence of highly productive methods and processes, which do not have to be discovered anew, but are available for transmission and appropriation, lays open wide opportunities for the under-developed countries to profit from experience already gained and results already well-established. A group of experts even hold the view that these countries may, under favourable conditions and with the necessary efforts and organisation, be able to achieve a more rapid advance, which would make it possible for them gradually to narrow the gap that separates them from developed countries.⁽¹⁾ But these experts, recognise the existence of some serious obstacles to any general technical progress in under-developed countries. First and foremost is the lack of capital. The adoption of technological improvements requires the use of capital goods which are in a true sense the carriers and embodiments of improved technology. In most of the under-developed countries, however, the producers are generally too poor to buy even relatively inexpensive producers' goods, e.g. improved seeds, fertilisers and insecticides. But in most

(1) United Nations Report, op. cit. Sec. 80, pp. 28-29

cases, whether in agriculture or in manufacturing industry, the cost of such capital goods as agricultural and industrial machinery is far beyond the purchasing power of the producers. Moreover, before technological improvements in the major fields of production can be achieved, large investments of capital will have to be made in basic industries and facilities, e.g., power, irrigation, transport and communications. "We cannot over-emphasise the fact that capital and technology are joint inputs in one process, the use of either of which involves necessarily the use of the other. Technological progress involves necessarily the investment of capital in human beings and in training and instructing them in the new technology, in administrative processes for its transmission, in capital goods embodying it, and in capital works and facilities supporting and developing the whole process". (1)

But here reference should be made to a serious qualification. To some minds, these experts have failed to grasp that the basic problem of development in under-developed countries consists precisely in the fact that it is essential to utilise more adequately and fully the labour resources as they now are in those countries, so as gradually to build up new forms of capital suited to the specific environment, resources, and aptitudes of the people themselves. Frankel, for instance,

(1) H. Frankel, *The Economic Impact of Capital Imports*, p. 10.

states emphatically that "the way to accumulate capital in those countries is in general to make the best use of that factor which is most abundant, i.e., labour - not to displace it by capital, which is relatively scarce, and has to be imported at considerable cost".⁽¹⁾ It is wrong to imply, as the authors do, that there has to be a sudden, rapid, and almost revolutionary shift to an entirely new structure of production in under-developed countries; to postulate a capital intensity in them akin to that which is found in the more advanced countries is unwarranted. Moreover, such revolutionary economic change may be economically and socially dangerous. It is apt to lead to an unnecessary degree of both economic and social disintegration. It may dissociate people from their established social pattern of living too rapidly, and so reduce them to the status of uprooted wage earners without the security previously provided by their social system. And it may establish a capital structure and types of activity, which the economy cannot continue to support when the flow of investment or aid from abroad ceases.

This sort of criticism should draw our attention to the special problems that may arise in the transmission of Western technology to under-developed countries. Whereas in well-developed countries

(1) S. Herbert Frankel, *The Economic Impact on Under-Developed Societies*, Essay V on United Nations Premier For Development, Section V, pp. 98-99

much technical research is designed to save labour as being the relatively scarce factor of production, in some under-developed countries where labour is over-abundant the problem is rather to find new techniques which are capital-saving.

Moreover, the technology of advanced countries needs frequently to be adapted to the special requirements of under-developed countries. It is sometimes suggested that all that is required to assist the development of backward societies is to give or to lend to them part of the world's accumulated technical knowledge and capital. But no two situations, no two regions, no two societies, in time or place, are alike. Many instances can be cited: fertiliser experimentation is needed to discover what is suitable to local environment; new strains of plants and livestock must be bred, new crop rotations must be found; manufacturing processes and equipment may have to be adjusted to local climatic and other conditions. It then follows that the technology of developed countries cannot simply be transferred. Large sums of money must be expended on research into the special needs of under-developed countries.

Another major obstacle to the general advance in technology is the lack of an educational and administrative structure through which the producers can learn the new technology. In under-developed countries there is the need for a well-developed administration in government departments of agriculture, well-staffed with experts and technicians. There is also the need

for training the higher personnel, the public administrators, who are required to formulate and carry out plans of economic development. It is, moreover, necessary to provide for a basic minimum level of education and literacy among the actual producers to achieve great advance in technology. It is also necessary to build up the educational institutions, without which this whole process cannot be developed and maintained at the proper level of effectiveness.

But in most of the under-developed countries it seems that the first goal in the sphere of education is solely to get rid of illiteracy. If, however, schemes were put into operation on such a grand scale that all children had to enter the elementary schools in order to learn the three R's, a major part, if not the whole, of the state budget of many countries would be spent on education. Still, education of children will be all the more costly as the standard of schooling is constantly rising; and this means that, with an ever-increasing cost of education, a government with a modest budget cannot afford it on a national scale. But apart from the high cost of the education of children, is a high standard of literacy genuinely so essential to economic development? The authors of the United Nations Report are well conscious of the fact that campaigns against illiteracy are no doubt useful in themselves, and a general high standard of education is certainly desirable. But from

the viewpoint of economic development they lay more emphasis on adult education rather than on the education of children. In their view, the adult must be educated in the job he is doing either on the farm or in the factory.

In agriculture it is the difficulty of reaching and teaching millions of farmers and of persuading them to change their primitive methods of agriculture that development planners should first endeavour to overcome. To reach them with new technology is an educational task which requires a great number of teachers in the field and a whole new body of techniques of adult education. This system is what has come to be technically known as 'mass education'. It is impossible to reach the masses, if only men of the highest qualifications are to be employed as teachers, physicians or agricultural extension workers. There should also be a vast number of men who have received no more than one or two years' training, to work in spheres where a five or six years' training is usually demanded in developed countries. "Some of the peoples of under-developed countries," the authors write, "resent attempts to expand this type of training, because they consider that the dignity of their country requires that only the best should be used. There is also some danger that international institutions may set too high standards of competence for the local technicians whose employment they have to approve. We consider these attitudes to be mistaken. There is much to be done that can be done after a short training, and much that

can be done better after a short training than it is done by persons further removed from the people. Economic development will be held up if under-developed countries are compelled to adopt the expensive standards of the more advanced countries" (1)

In industry plans for economic development need to begin with the expansion of domestic institutions for training the personnel required at all levels. Even apart from the cost and scarcity of foreign technicians, domestic training in the environment where people have to work has obvious advantages. Moreover, no development is lasting or self-generated which is merely imposed from above, or imported from abroad. The new education and techniques will show large results only when they are completely assimilated and begin to develop on lines of a native tradition. But it is to be noted here that, if a new industry based on a new technique is to be established, it is by no means necessary to start side by side a technical institute with a view to teaching that technique. If the required workers have the technical background, they have then to be trained on the job, and an educational programme is to be started by the employers concerned for this on-the-job training.

But it must be pointed out here that the process of development is not merely a process of mass education on which the authors of the United Nations Report lean heavily for rapid economic development. Indeed, they tend to make this one of the

(1) United Nations Report, op. cit., Sec. 95, p.34

main considerations in the choice of the type of education that should be most appropriate for under-developed societies.

One may agree with the general principle that 'investment in people' should not suffer at the expense of a too high priority for investment in material resources. But it is doubtful that these generalisations get us very far unless we are prepared to be far more critical of the fundamental meaning to be attributed to such terms than appears to be the case at present. In Frankel's view, a whole people can no more be given rapid economic development by investment in mass education, than it can be given 'democracy' by 'investment' in mass political training. For quite apart from the time all this takes, what is involved is neither just another ready-to-hand goal of action, nor the transfer of a new set of techniques, but the necessarily slow growth of new aptitudes, and of new ways of doing, living, and thinking. "The problem", he writes, "is not to wipe the slate clean in the under-developed countries, and to write our economic and technical equations on it, but to recognise that different peoples have a different language of social action, and possess, and, indeed, have long exercised, peculiar aptitudes for solving the problems of their own time and place, aptitudes which must be further developed in the historic setting of their own past to meet the

(1) S. Herbert Frankel, *op. cit.*, p. 95.

For further study see J. R. Condliffe, *Technological Progress and Economic Development*, Delhi School of Economics, Occasional Papers No. 2, Delhi, 1951.

exigencies of the present and the future".⁽¹⁾

5. THE HUMAN FACTOR

IN INDUSTRIAL EFFICIENCY

So far we have been dealing with the general and special problems that may arise in the transmission and appropriation of Western technology. But even if all the obstacles to the absorption of new production methods and techniques were removed, there would still remain another problem. It is now a commonplace that the human and psychological factors in industry are no less important than the technical aspects, and that the full utilisation of the valuable asset of Western technology and industrial resources must come from a whole hearted co-operation between managements and workers, and willingness to adapt themselves to new conditions.

As has been mentioned earlier, this whole-hearted co-operation would not be forthcoming in any under-developed country unless the managements took the responsibility not only of ensuring the use of the more up-to-date techniques of applied science, but of providing the leadership vital to any healthy organisation. In addition, the trade unions must become free, independent and well enough organised to safeguard and improve the working

(1) S. Herbert Frankel, *op. cit.*, p. 96.

For further study see J.B. Condliffe, *Technological Progress and Economic Development*, Delhi School of Economics, Occasional Papers No. 2, Delhi, 1951.

(2) *o.p.* Part II, Chapter 5, Sec. 1, p. 201.

and living standards of the working people as well as to make the positive contribution they alone can do in promoting industrial efficiency. (1)

At the risk of oversimplification, the problems of capital-labour relations may be categorically divided into three groups: (1) economic problems, including those relating to the workers' earnings; (2) social problems, including the workers' demand for improved social status; (3) psychological problems, including the workers' unconciliatory attitude towards the management.

As regards the first two groups of problems, it cannot be denied that trade unions today are quite defective in most under-developed countries; and in many instances labour legislation has been the principal substance of the protection enjoyed by labour. (2) But many have high aspirations as to the directions in which trade unions should develop in the future in such measure that they will increase their power of collective bargaining and on the workers' behalf bargain with employers for better conditions of work, for better terms of employment, and for extended welfare measures.

In improving the lot of the working classes, trade unions in under-developed countries, should achieve their main aim and purpose; but in pursuing a policy for increasing industrial efficiency in co-operation with managements, trade unions should

(1) c.f. Part II, Chapter 6, Sec. 2 pp. 190 - 196

(2) c.f. Part II, Chapter 8, Sec. 3, pp. 228 - 229

embark on a scheme of full-time training and education for their members in co-operation with technical institutions. For it is being realised more and more that, if workers are fully to co-operate in the vitally important matter of efficiency in industry, they must be competent to negotiate with managements with confidence on the technical aspects. It would be foolish, however, to deny that there are difficulties in the practice of consultation between workers and managements. Managerial pride often leads managerial elements into resistance against the advice and suggestions which emerge from the non-technical elements within an industry. They may regard the acceptance of such ideas as a reflection on their own ability, and in consequence a reduction in the measure of their authority. On the other hand, managements must realise that the practical experience of workers, which after all is the basis of technical knowledge, is of the utmost value to industry. The common aim of the managerial elements and the workers in a given industry can benefit both, while also creating possibilities of advantage to the whole community.

But even if the workers are to be technically trained and practically experienced, this is not enough to stimulate their interest in industrial efficiency. There is no better method of engaging the worker's interest in the efficiency of the plant and the need for keeping costs low than by the general application of incentive schemes. New equipment and plants are not

sufficient in themselves; they are only the means, the tools of abundance. If industry must bring average production to the highest possible level, this would involve the adoption of incentive schemes which vary according to local conditions and products. They are usually based on payments by time and motion study, piece work and payment by results, and on a combination of all three. But incentive schemes as the key to increased productivity will never be readily and fully accepted unless the trade unions have agreements with managements which give union officials the right to participate and to check on the methods and time standard as they are developed and applied. Such new managerial techniques must become a general practice throughout industry, if the under-developed economy is to achieve any industrial development.

It is well to bear in mind the experience of British industry. In the past decades, trade unions feared the introduction of these incentive schemes not without good reasons in view of experience between the two wars. But during the post-war years there has been an entirely new approach and a new appreciation of their purpose and consequence. The workers generally, and particularly shop stewards, have themselves accepted the new responsibility and understood the principles and methods of the incentive schemes. Consequently the demand for these new methods of industrial management have come from the rank-and-file workers themselves. In every factory

where these schemes have been introduced on the basis of co-operation rather than arbitrary management decisions, higher productivity and greater output at lower costs have resulted, and workers' earnings have increased.

The American industry is another case in point. So great has been the momentum of American production that the American people are able to enjoy the highest living standards in history. It is true that there are many natural factors making for American prosperity, but even taking these into consideration the major reason for this great productivity is the much higher industrial efficiency of American industry, as compared with Britain and Western Europe. In turn this is largely due to the fact that the American workers, through their trade unions, have accepted as a first principle the truth that their standard of living is dependent on a constantly increasing rate of output and have not been afraid to embrace new ideas on incentive schemes and industrial management.

As regards the psychological aspects of the problem of capital labour relations, in the under-developed economy there can be distinguished several types of labour administration. In the old-fashioned factories the manager directly controls labour. From the point of view of labour administration, this is generally unsatisfactory, for the manager usually has many other duties to perform in the running of his business and is thus not able to devote sufficient time to the care of the

workers. In some other factories the engineer directs the workers; this is more natural, as he must employ workers to operate the machines. Though a number of engineers are broad-minded and humanitarian, they are by training and experience experts in machinery, but are frequently awkward in dealing with human beings. In many factories, however, the control of labour is in the hands of the traditional foreman. The defects of this practice lie in the fact that the foreman is usually ignorant, conservative and biassed. He will not be able to introduce scientific improvements and will not be fair to all the workers under his control. As regards the all important question of vocational training, psychological testing and of sympathetic understanding, rarely has any worthwhile attempt been made in any under-developed country.

There are no arguments, of course, for ignoring the vital need for accepting the most up-to-date methods of industrial organisation and techniques. Not to do so would make certain the industrial decline, and not the development, of under-developed areas. Such obstacles as do exist must be resolutely tackled and overcome, but there is no short cut or easy road to a solution. It is an essential pre-requisite of economic development in those areas that leaders of management and labour should accept the basic truth that raising productivity and

eliminating friction and inefficiency is a joint task, to be pursued in the spirit of common endeavour and common interest.

It is one of the duties having the highest priority for the governments concerned to take up this cause and to bring the leaders of industry together. Once they have been brought together, the first step is to arrive at agreement as to what really are the specific obstacles that are preventing the co-operation between management and workers on the actual job on the workshop floor. When both parties have come to a common agreement as to the nature of these obstacles, attention can be directed towards removing or circumventing them. Some of the obstacles may be inadequate management, or ineffective leadership on the shop floor due to inadequate training of officials or unclear organisational structure. Some of the obstacles may be the lack of direct interest in improved efficiency of industry; or inadequate channels of negotiation and discussion perhaps due to the apathy of the rank and file; or suspicion and the assumption that management is and always was "the enemy".

This list is far from complete, but it is sufficient to show that the onus of removing the obstacles that stand in the way of co-operation falls in the main, and certainly in detail, on managements. The trade unions, on their side, can modify the climate of thought of the rank-and-file workers and prepare the way for a closer co-operation between the two sides of industry.

the making of capital goods, CHAPTER 20. form of tools and instruments, machinery, transport facilities, plant and equipment, and all the various forms of real capital that can so greatly increase

SAVING INCENTIVES

productive efficiency. The term is sometimes used to cover So far we have been dealing only with one particular facet human as well as material capital: it can be made to include of the problem of capital formation in under-developed countries. investment in skills, education and health. But the discussion The more fundamental difficulties that lie on the supply side here will be limited to the accumulation of material capital. have been deliberately kept off-stage for two reasons: for the

sake of orderly discussion as well as for removing a deep-rooted misconception in the minds of so many people in those countries.

It is that, once an under-developed country lays its hands on capital funds from whatever source, domestic or foreign, the problem of economic development will automatically look after itself.

But capital formation requires an act of investment as well as a capacity to save. The two things can and should be distinguished, at least for purposes of analysis. Having considered the various ways in which investment incentives have to be created in any under-developed economy, it is then proposed to discuss the more serious problem of the supply of capital. However, as we turn to consider the potential domestic sources of capital formation in such an economy we find that it is impossible to go on without knowing what is meant by the term 'capital formation' in an economic sense. It is that society does not apply the whole of its current productive activity to the needs and desires of immediate consumption, but directs a part of it to

the making of capital goods in the form of tools and instruments, machinery, transport facilities, plant and equipment, and all the various forms of real capital that can so greatly increase productive efficiency. The term is sometimes used to cover human as well as material capital: it can be made to include investment in skills, education and health. But the discussion here will be limited to the accumulation of material capital.

1. CONCEALED SAVING POTENTIAL.

In connection with the problem of disguised rural employment, it has been pointed out already that there is the possibility of taking the surplus people away from the land, and anything they could produce elsewhere would be a net addition to the real national income. Then why not set them to work on such capital projects, as for instance, irrigation, drainage, roads, railways, housing, factories and so on? But how are these various forms of capital formation to be financed? In real terms, how are people to be fed when they are set to work on projects of this sort? The answer seems to lie, at least in part, in the concept of concealed saving potential.

It is possible to feed the surplus people through the normal voluntary saving that may take place to some extent even in a poor, over-populated peasant society. But this sort of saving is very likely to be quite inadequate relative to the labour resources to be

mobilised; and is likely, moreover, to be used for purposes other than the implementation of capital projects. This voluntary domestic saving may be supplemented through compulsory saving by means of taxation; but even this, as we shall see later on, may turn out to be very little in comparison with what is really required. There is, nevertheless, the second possibility of an inflow of capital from abroad; but this again, besides being uncertain, is likely to be inadequate for several reasons. However, there is a third possibility of feeding the people transferred from the land to the new investment projects; and some authors like Ragnar Nurkse place much emphasis on this source of capital supply.

On close examination, says Nurkse, we find that the state of disguised unemployment implies at least to some extent a disguised saving potential as well. The concept can easily be illustrated in physical terms. As things are, those surplus labourers who are unnecessary on the land are sustained by the other labourers, even though personal identification of the two groups is, in the nature of things, impossible. The latter group are performing 'virtual' saving in the sense that they produce more than they consume. But the saving runs to waste, for it is offset by the consumption of the former group who could be dispensed with, who contribute nothing to output. If the latter group of peasants were to send their useless dependants to work on capital projects and if they continued to feed them there, then their 'virtual'

saving would become 'effective' saving.

Thus the use of disguised unemployment for the accumulation of capital could be financed from within the system itself. There is no question of asking the peasants who remain on the land to eat less than before, only of preventing them from eating more. What is wanted is that they go on feeding their dependants who leave the farms to go to work on capital projects and who, in effect, continue to be dependent for their subsistence on the peasants remaining on the farms. All that happens is thus a mere re-allocation of labour in favour of capital formation; and there is in principle no necessity for either group to tighten their belts, always provided that the initial assumption is valid. It is that surplus labour does exist which can be withdrawn without a fall in total farm output.⁽¹⁾

"Here we have a relationship between consumption and investment," says Nurkse, "which stands midway between the classical and the Keynesian approach. In the usual classical model, an increase in the rate of capital formation requires a reduction in consumption. In the Keynesian world of industrial unemployment, consumption as well as investment can be expanded at the same time. In the case now before us, the situation differs from the Keynesian model in that it is impossible to expand both consumption and investment. On the other hand, it is possible to increase capital formation without having to cut down the level of consumption."⁽²⁾

(1) C.f. Ragnar Nurkse, *op.cit.* p.38.

(2) *Ibid.*

This is probably enough to make clear the sense in which disguised unemployment in under-developed peasant societies may be said to contain a hidden source of saving available for economic development. Nurkse, however, seems to be well aware of all sorts of difficulties as soon as one begins to consider its practical application. True, everything depends on the mobilisation of the concealed saving potential in the shape of the food surplus that becomes available to the peasants remaining on the farms when their dependants go away. But this mobilisation will not be complete if the remaining peasants cannot be stopped from eating more than before. Neither will this mobilisation be complete if the investment workers who were formerly unemployed in disguise have to eat a little more than before because they are now more actively at work, or because they need to be given an inducement to leave the farms in the first place. But how much inducement will be necessary is likely to depend on circumstances. In this sense, Nurkse recognises a leakage which may develop in the subsistence fund available for capital formation through increased consumption by the remaining peasants or by the new investment workers, or both. There is, moreover, a leakage which may arise through the cost of transporting the food from the farms to the places where the capital projects are established. This particular leakage can be reduced by scattering the projects in rural areas, but in practice it can probably never be entirely suppressed.

In these circumstances the formation of capital through the

use of surplus labour is self-financed only if the mobilisation of the concealed saving potential is completely successful. Otherwise the scheme is very likely to break down when the amount of saving, or in real terms the subsistence fund available to support the workers engaged on real capital accumulation, proves insufficient. For if the investment workers will not get enough to eat on their new jobs, they will run back to the farms to resume their previous existence and absorb on the spot the food produced there. At first sight it seems to be a question of all or nothing. On reflection, however, it will be observed that the surplus labour can still be employed for capital formation if some complementary saving can be secured from outside the system to close the deficiency of saving that may arise within it. Some complementary saving might become available from domestic sources, and there is also the possibility of capital imports. So it may not have to be all or nothing, and by means of resources obtained from outside the system, it will be possible to mobilise the whole or part of the disguised unemployment for the purpose of capital formation. And the degree of mobilisation possible will depend on the amount of complementary saving available and on the relative size of the leakage. It is then our task to discuss the possibility of obtaining complementary saving from outside the system.

2. SAVING INCENTIVES

INSTITUTIONS, INFLATION and TAXATION

In all under-developed countries, paucity of capital resources necessary for financing development is one of the major bottlenecks. In such countries, the rate of saving is normally negligible so that only a very inconsiderable part of savings is mobilised to increase productivity and raise the average living standard. This is largely due to the very low incomes of the masses of the people in those countries, which could hardly leave any margin of savings after provision for the basic needs of life. This is also due to the lavishness of the wealthier classes of these communities in their expenditure on articles of luxury simply for conspicuous consumption.

The new capital resources necessary for financing development may be imported from abroad whether by grant or by loan.

To what extent under-developed countries can rely on foreign resources is a matter of speculation, particularly when account is taken of the several obstacles standing in the way of all types of private foreign investment, the political misgivings attendant on government lending, and the administrative and financial limitations on the powers of international lending agencies. Under-developed countries therefore will have to count first on their domestic capital resources.

In so far as domestic saving is concerned, the first difficulty is, of course, that its volume is small because of the low level of income. But, then, there is the further trouble that such saving as does take place tends to be used unproductively: it tends to be put into real estate, gold, jewellery, commodity hoards, and hoards of foreign or domestic currency. This unfortunate tendency is usually explained by reference to inadequate financial organisation or lack of education. While such institutional explanations seem to have some validity, this tendency may also reflect a more deep-seated economic condition. It is the deficient inducement to investment which is due to the poverty of the domestic market. Thus a source of domestic resources may be tapped in the form of private hoardings of gold and foreign exchanges, constituting in some countries as much as 10 per cent of their national incomes. No doubt, it would be socially desirable to get these not insignificant hoards used for domestic capital formation; but as information about these hoards is very scanty, it would be immensely difficult to get hold of them. Nor, of course, would these hoards constitute a permanent source of finance. Consequently more reliance should be placed on increasing current savings rather than on the mobilisation of already existing hoards of gold and foreign or domestic currency.

To increase voluntary savings necessitates the establishment

of savings institutions, the effect of which on the level of savings partly depends on their number and their accessibility, and partly on the interest rate they pay. People with low incomes might save more if these institutions were widespread and the government urged people by propaganda to save. People with medium sized incomes save through such institutions as well as insurance companies, investment in their own business or in shares and industrial securities, so that the organisation of a stock market might induce a little more middle class saving. As far as the higher income class is concerned, the willingness to save is not hindered by the lack of savings institutions. The problem presented by this class is rather how to divert and mobilise their savings into more useful purposes. Mal-investment of savings may be partly tackled by means of a discriminatory tax system implying the grant of tax exemptions and subsidies. Thus higher, lower, zero and 'negative' rates of tax might be imposed on different types of investments, and thereby ensure the flow of savings from the less to the more useful purposes consistent with the development plan. In other words, the yield of land and real estate ought to be subject to relatively high rates of tax, whilst the yield of industrial ventures and agricultural enterprises, as distinct from the passive ownership of land, ought to be subject to relatively low rates of tax or should even be subsidised in some cases.

development in this way: political pressure on the

It is partly because the capacity, and partly because the willingness, to save is low in under-developed countries that much reliance should not be placed on stimulating voluntary savings as a source of financing more rapid development. Given the small propensity to save in those countries, if more ambitious development plans were set in motion, this would inevitably lead to inflationary tendencies. Although a certain measure of inflation is unavoidable in the way of carrying out intensive development, financing development by inflation is by no means desirable. Under-developed countries have much to lose from inflation. It distorts the profitability of various types of enterprises and induces people to put much capital into speculative enterprises and into hoards of gold and foreign exchange. It also discourages the inflow of foreign investment, and by reducing the real value of small savings, it discourages the lower and middle income groups from continuing to save. Once it starts, inflation may generate forces which reinforce it and make it cumulatively more difficult to end. Hence it would be better to try to finance more rapid development by means of collective savings by the state, i.e., creating a budget surplus on current account by way of taxation.

It is theoretically possible to increase domestic capital formation by compulsorily reducing consumption below its present level. But one may envisage three obstacles in financing development in this way: political pressures to protect the

living standard of the masses; the unfavourable reaction to taxation by the middle and higher income groups who have an important part to play in the process of development; and the reaction of the wealthiest classes to taxation by reducing their savings rather than their consumption. These obstacles can be removed by political action. The government should urge all classes to sacrifice and contribute to the process of development, and should start to tax heavily the luxury articles consumed by the wealthiest classes in order to win the confidence of other classes. mention: royalties, export duties and import duties.

But when taxation is employed as the primary means of providing the requisite finances for development, it is not necessary that the development programme should be undertaken by public enterprise. Heavy taxation may be used merely to set free productive resources, and the government may merely accumulate a budget surplus or tax credits. In practice, however, taxation is often associated with promoting development of a public enterprise type. The danger of over-investment in public enterprise might be met by devoting a part of the proceeds of taxation to increasing the funds of public financial institutions catering for agricultural and industrial development, or to set up industrial centres in which factory space and all basic facilities are given to private entrepreneurs on easy terms.

It is evident that taxation hitting consumption to release

resources for capital formation contributes to combat inflationary tendencies, if any, for it reduces effective demand for certain resources which are thus set free and may be transferred by appropriate policies to economic development. Since taxation is designed primarily to reduce consumption in order to increase collective savings by the state, such indirect taxes as import and export duties, excise duties and purchase taxes are the most appropriate category of the fiscal structure. Among the various types of indirect taxation, however, three taxes deserve special mention: royalties, export duties and import duties.

In some under-developed countries, there are foreign companies which make and export exorbitant profits simply because the local governments have signed away some natural resources without demanding an adequate royalty or rental in return. Foreign companies should not make and export exorbitant profits and the government concerned should ensure receiving adequate royalties in return for the concessions. Moreover, these royalties should be exclusively devoted to the financing of development. Otherwise, ultimate impoverishment of the country must follow as a result of the depletion of its natural resources, which is not matched by a corresponding increase in its productive capital.

In regard to export duties, some countries have found a source of savings by taking advantage of a temporary, or a

permanent, improvement in their terms of trade. The method is designed to prevent exporters or producers from getting the full benefit of the increased price of their goods in foreign countries. This can be done by imposing an export tax which varies directly with the foreign price, or by establishing a government marketing agency which buys produce at a low price and sells it at a higher price. Sizable sums have been taken away by governments in this way. But the difficulty is to know what part of the proceeds can safely be used to finance capital formation, and what part must be held in reserve against cyclical deterioration of the terms of trade.

Import duties, on the other hand, can be employed as a fiscal measure for promoting development in four different ways. They may be imposed for revenue purposes which would make possible the operation of development projects without resort to inflationary methods of finance. They may also be employed as a restrictive measure on consumption of imported goods; but, in this case, they have to be coupled with direct controls or other types of indirect taxation in order to rule out the possibility of the substitution of home-produced for similar imported goods. Moreover, selectivity in imports is recognised as a legitimate measure in many under-developed countries where a high proportion of the national income tends to be spent on luxury imports. Higher import duties are therefore to be levied on such luxuries to the benefit of other essential capital

equipment or consumption goods which may be liable to lower rates of duty. In this way import duties are made equivalent to a progressive income tax which primarily hits the higher income brackets. Furthermore, they may be levied with a view to protecting 'infant' domestic industries, producing similar products or substitutes. Import duties may cover therefore a wide range of objectives, and if carefully selected may be expected to play their part in the promotion of economic development.

This discussion of the savings problem in under-developed countries leads us to the conclusion that what needs to be done first is to induce the lower classes to save more by developing a taste for saving, the middle classes by creating saving institutions and setting up building societies, insurance companies and organised stock exchanges. Nevertheless, it is unlikely that development would significantly be financed by voluntary savings owing to the very low incomes of the masses of people in those countries. If, however, these voluntary savings were coupled by compulsory savings, i.e., by way of increased taxation, still the prospects would seem rather poor, for this fiscal measure of financing development would most probably meet with obstacles and political resistance by the masses. If, however, both voluntary and compulsory domestic savings proved to be inadequate for rapid economic development, it may be suggested that foreign savings from abroad may be invoked to fill

the gap. But this source of finance, as we shall see later, is not only uncertain but also inadequate. This is indeed a rather pessimistic view of the supply side of the problem of capital formation. Is there any other way of finance, apart from borrowing from abroad or increasing voluntary or compulsory savings? The government to use the proceeds for capital formation.

The authors of the United Nations Report have proceeded along more optimistic lines of argument, when they pointed out that economic progress has actually been achieved alongside increasing inequality of incomes. In the past, economic progress was only possible when the rich became richer and the poor poorer. It is only the increasing inequality of incomes which gave the impetus to progress. Hence an easier and more acceptable policy is to increase savings by holding consumption constant or, at least, by allowing it to rise only in lesser proportion. This is less difficult to achieve, and it is the normal way that countries have developed in the past. Starting from a position where savings were a small portion of the national income, these countries have climbed to a position where savings are a much larger portion of the national income, by increasing production faster than consumption. The mechanism has been growing inequality of income, development giving rise to large profits which were ploughed back in the creation of large private fortunes. But the authors do not overlook the cardinal fact that in our

days the creation of large private fortunes is less likely to be permissible. In view of this practical difficulty, the authors recommend a policy to be based on siphoning off the increase of production into the hands of the government, rather than into profits, and creating financial institutions which enable the government to use the proceeds for capital formation. In their opinion, this is an easier policy than one which is purported to involve an absolute fall in consumption. (1)

3. SAVINGS AND THE DEMONSTRATION EFFECT

We may now go further afield to investigate a hypothesis based on the unequal income distribution in the world, which both theory and international economic policy have too often tended to ignore in the past. This hypothesis may throw some light on the problems of economic development in their international setting.

Our starting-point is the view taken by James S. Duesenberry in respect of consumer's behaviour. This view places great emphasis on the fact that individual consumption functions are interrelated and not independent. They are interrelated, first, through the desire for social emulation by means of conspicuous consumption. The point was made familiar especially by Thorstein Veblen; and it may be important in inter-personal relations and perhaps of some use in the explanation of consumption and saving habits that prevail in economically backward countries. There is

(1) c.f. United Nations Report, op. cit. Sec. 113, p.39.

another way in which individual consumption functions are inter-related and this will be our main concern. Duesenberry calls it the 'demonstration effect'. When people come into contact with superior goods or superior patterns of consumption, with new articles or new ways of meeting old wants, they are apt to feel after a while a certain restlessness and dissatisfaction. Their knowledge is extended, their imagination stimulated, new desires are aroused, the propensity to consume is shifted upwards. (1)

Thus the interdependence of consumers' preferences, stressed by this theory, may significantly affect the choice between consumption and saving. The amount of saving performed by an individual depends not only on the absolute level of his real income, but also on the ratio of his income to the superior income level of other people with whom he may come in contact. Thus when the interdependence of consumers' preferences is to be taken into consideration, we realise that a more unequal distribution of income may reduce the average saving ratio, instead of increasing it as is commonly assumed. The reason why 75 per cent of American families save nothing is not so much that they are too poor to save. It is rather that the example of the consumption patterns kept up by people in the top 25 per cent

(1) c.f. James S. Duesenberry, *Income, Saving and the Theory of Consumer Behaviour* (Cambridge, Mass. 1949).

(1) Ibid., p. 59
 (2) *Journal of Political Economy*, op. cit., p. 67

income groups stimulates their wants to such an extent that virtually nothing is left over for saving.⁽¹⁾ All this is a mere hypothesis, but it seems to be consistent with the facts. The question then arises as to whether a hypothesis of this sort might not usefully be applied to international economic relations. Could it not be that the consumption functions of different countries are interrelated in a similar way? In this respect, Nurkse believes that on the international plane the effect of unequal living standards is not dependent on Veblen's point that the propensity to spend is partly based on the desire for conspicuous consumption, but on demonstration leading to imitation. Knowledge of, or contact with, new consumption patterns opens one's eyes to previously unrecognised possibilities. It widens the horizon of imagination and desires. It is not just a matter of social snobbishness.⁽²⁾

"New products constantly emerge from the course of technical progress," Nurkse writes, "which modify existing ways of life and frequently become necessities. In the poorer countries such goods are often imported goods, not produced at home; but that is not the only trouble. The basic trouble is that the presence or the mere knowledge of new goods and new methods of consumption tends to raise the general propensity to consume. New goods, whether home made or imported, become part of the standard of living, become indispensable or at least desirable, and are

(1) Ibid., p.39

(2) Ragnar Nurkse, *op. cit.*, p.61

actively desired as the standard of living rises. We should distinguish here between two senses of the term 'standard of living': first, standard simply in the sense of aspiration the norm to which one aspires, or the measuring rod; secondly, standard in the sense of what a country or a community can afford on the basis of its own productive efforts. Some articles of luxury consumption may well be a part of a country's standard of living in the first but not in the second sense". (1)

Nurkse then proceeds to point out that the American standard of living enjoys considerable prestige, for it has come to be noticed that American consumption patterns include many unnecessary luxuries, and this presents a serious problem for the less advanced countries in the world today. He illustrates his hypothesis in its international setting by reference to the following table based on national income estimates for 70 countries, compiled by the United Nations Secretariat and expressed on the common basis of United States dollars of 1949 purchasing power. (2)

(1) Ibid., p.62

(2) Ibid., p.63

TABLE SHOWING WORLD

INCOME DISTRIBUTION, 1949

Groups of Countries	World Income (Percentage)	World Population (Percentage)	Income Per Head (Dollars)
High-income countries	67%	18%	915
Middle-income countries	18%	15%	310
Low-income countries	15%	67%	54

Source: A calculation based on National and Per Capita Income in 70 countries, 1949, Statistical Office of the United Nations, 1950.

It follows from this statistical evidence that two-thirds of the world's income goes to the top 18 per cent of the world's population. This group consists of the United States, Western Europe, Australia and New Zealand. Then there is a small middle class, including Argentina, Uruguay, South Africa, Israel and some countries in Eastern Europe. The lowest income groups represented in the table comprises two-thirds of the world's population and receives less than one-sixth of the world's income. Thus the so-called backward countries of the world make up two-thirds of the human race, and they cover most of Asia, Africa, South-eastern Europe and Latin America. The last column of the table gives some idea of the average income levels in

the three groups of countries. The income per head of the first group, it will be observed, is about seventeen times as high as that of the third group. Even though the estimates on which they are based are extremely crude and subject to all kinds of doubts and reservations, yet the picture they give is not largely misleading. *Relative level of real income that determines the*

capac However, it is not only that international discrepancies in the standards of living are very great, but the fact that *relative* communication in the modern world is so much closer than ever before entails the result that knowledge of these discrepancies has greatly increased. True, the strength of the demonstration effect varies a great deal as between countries and as between different income groups in under-developed countries. It may be concentrated among the upper income groups in the towns, but it may also be diffused, though lightly, even among the lower income groups, thanks to education and closer communication. The demonstration effect may be an important factor in most parts of Latin America, but it may be weak and relatively insignificant in India and most parts of South-eastern Asia. But practically all low-income countries today are to some extent affected by the attraction of the consumption patterns of economically advanced countries. This attraction is a handicap for the late comers in economic development. It affects not only voluntary personal saving but also renders it politically more difficult to use taxation as a means of compulsory saving and to resist demands for

government spending on current account. The use of potential domestic sources of capital can be seriously hampered by the impatience and dissatisfaction which the demonstration effect tends to produce.

Thus it may be said that it is not only the absolute but also the relative level of real income that determines the capacity to save. If that is so, foreign investment may not be capable of removing this handicap. An increase in relative income in the less advanced countries is not simply a matter of increasing productivity; it is a matter of diminishing the gap between their income levels and that of the more advanced countries. But foreign investment does not guarantee a reduction in this gap. And there is the disturbing possibility that, even if the gap should remain unchanged, a rise in the living standards of the poorer countries, accompanied by an equal rise in those of the richer, may tend to increase the intensity of contact and communication between them and hence the strength of the demonstration effect.

In this sense there is a different view of international economic relations. The traditional view generally implies that a high level of productivity and real income in one country cannot possibly hurt other countries and that, on the contrary, prosperity tends to spread. There are, of course, many ways in which one country's prosperity will favourably affect economic

conditions in its neighbouring countries as, for instance, in the sphere of scientific knowledge. But the demonstration effect now discussed is unfavourable. A high income and consumption level in an advanced country can do harm in that it tends to reduce the domestic means of capital formation in the under-developed countries, for it puts extra pressure on countries with a relatively low income to spend a high proportion of it.

Raul Prebisch in his stimulating essay places much emphasis on the fact that the level of productivity in Latin America is low because of lack of capital, and that capital is scarce because of the small margin of saving, which is due, in turn, to low income and low productivity. But he also recognises the importance of the attraction exercised in the poorer countries by the consumption patterns of the more advanced countries.⁽¹⁾ The small rate of saving in the former countries is due not only to the low absolute level of real income but also to the higher propensity to consume which is the outcome of the attraction of superior forms of consumption. The vicious circle that keeps down the domestic supply of capital in low-income countries is bad enough by itself. Besides, Duesenberry's hypothesis in its international setting reveals the fact that the vicious circle tends to be made even worse by the stresses that arise from relative as distinct from absolute poverty, stresses that are based on demonstration leading to imitation.

(1) c.f. Raul Prebisch, 'The Economic Development of Latin America and its Principal Problems,' p.5

CHAPTER 21.

THE SUPPLY OF CAPITAL.

It is a commonplace that economic progress is a function, among other things, of the rate of new capital formation. In progressive countries, net capital formation at home is at least 10 per cent of the national income and in some of them it is substantially higher. By contrast, we find that in most under-developed countries net capital formation is not as high as 5 per cent of the national income, even when foreign investment is taken into consideration. In many of these countries, the savings have been sufficient only to keep up with population growth, so that only a negligible part of the new capital, if any, has actually become available for increasing the average standard of living.

How to increase the rate of capital formation is then an urgent problem. So far it has been dealt with in terms of saving incentives. As has been pointed out, domestic capital formation is a matter of institutions, a matter of inflation and a matter of taxation. Here it is proposed to consider the question of capital formation in its broader context, taking into account the contribution that might be made by transfers of capital from abroad.

1. DOMESTIC SOURCES OF CAPITAL.

If large-scale industrial and other investment is to be carried out, savings must be generated to offset this increment of investment. Foreign savings, private voluntary savings out of private incomes, and collective or compulsory saving, which is achieved if the state collects more in revenue than it disburses in current expenditure, are the principal sources of capital formation.

Statistical information about private voluntary savings in many underdeveloped countries is very scanty indeed. But on the basis of other information regarding saving propensities in some other countries, it may be reckoned that the rate of saving varies between 1 and 2 per cent of the national income. Domestic capital formation beyond this limit might therefore bring about inflationary tendencies. Since it is hard to increase voluntary savings very much in a country where the standard of living is very low, it may be said with confidence that voluntary savings are likely to be far too small to satisfy the capital targets. Hence it might be suggested that for some time to come the main source of domestic capital resources will have to come through public finance.

One of the policies of budgeting for development is the achievement of an overall deficit, which may be brought about by various methods: a reduction in revenues by means of tax concessions, or a reduction in the trading profits of public

undertakings, or by increased expenditure without tax remissions. In this way the government may resort to borrowing for investment, or even to the printing press if unemployed resources characterise the economic situation. By implication this reasoning makes the distinction between a current budget and a capital budget of prime importance. Although such budgeting policy may be appropriate under specific conditions, as a broad rule it would lead to inflationary tendencies. For, in most of these countries output responds less easily to an increase in effective demand even when there is unemployed labour, simply because of the lack in factory equipment. Owing to the fact that supply elasticities are very low, an increase in the effective demand as a result of increased public spending does not increase output, or increases it only very little. Its main effect is to cause prices to rise and start an inflationary spiral. For this reason, we have to rule out the possibility of financing capital formation by deficit budgeting, and to rely more on creating surpluses of the state budget on current account; the overall budget being balanced except for foreign loans. Collective savings by the state can only be obtained by checking consumption and thus freeing resources for the investment programme. The government will therefore have to check overall consumption by fiscal measures, and the budget surplus thus effected can be used to finance capital formation.

Unless foreign loans are obtained, the problem now arises of

how the additional collective savings necessary for the investment target are to be provided. The choice is between reduction in current expenditure and increasing revenue from taxation.

Cuts in public expenditure are a very popular demand in many under-developed countries. However, they are usually slow in maturing, and sometimes harmful to the efficiency of the service. Strict economy in government expenditure is certainly desirable, and overstaffing of government departments or of state enterprises should be eliminated. But such staff reductions can only be possible if reorganisation of the administration is carried out, leading to a better division of labour and an improvement in administrative efficiency. Thus not too much reliance ought to be placed on these potential economies in government expenditure, and it is almost certain that increased surplus must mainly come from higher revenues.

It may be assumed that with existing rates of taxes, total yields will rise either when prices rise, or when activity is pushed to higher levels, or when productivity rises. Methods of assessment and collection can also be improved in most under-developed countries. Income tax and general revenue tax and death duties are the most promising fields in this respect. Prevention of tax evasion by strict measures and the immediate collection of tax arrears, if any, will bring forth not inconsiderable yields. Moreover, land tax is capable of producing fairly large amounts of revenue if it is adjusted to

present inflated price levels. No system of financing a higher rate of development can be evolved which does not place some of the burden on the agricultural population.

From the point of view of economic development, however, a faster rate of development may require, among other things, a greater revenue surplus which must largely be obtained through higher taxation. In other words, both direct and indirect tax rates have to be raised in order to contribute to the budget surplus. But in respect of indirect taxes, significant increases in their rates could only be made in the absence of political resistance by the poorer and middle classes. From the revenue point of view, however, the high yielding low-cost taxes are those on luxury goods. Thus a new purchase tax on these articles of luxury may be deemed necessary for development purposes; but this measure of course requires a more intimate knowledge of consumption habits and a detailed study of family budgets. As far as rural and provincial towns are concerned, one feels that a local income tax on the famous Swedish model may be an appropriate fiscal measure to increase the tempo of rural development.

Taxation, however, may not only be employed as a main method of financing development by releasing a part of the community's resources for this purpose, but it can also indirectly contribute to development in other ways. For it may be necessary to use controls to ration luxury consumption which necessarily competes with the development programme. Thus taxation can be employed not

to effect an over-all reduction of consumption expenditure, but to effect a reduction in certain types of consumption expenditure. Duties can then be levied heavily on articles of luxury, but lightly on capital goods, e.g., machinery, motors, raw materials and similar real resources which are of prime importance to under-developed countries. However, this fiscal measure would have to be supplemented by levying a purchase tax at the same rate on similar home-produced articles of luxury. Otherwise, the reaction of the rich class would be to substitute home-produced for imported luxuries.

It may also be necessary to use controls to ration unessential investment which may compete with the development programme. Differential rates of income tax would be one method, among others, to perform this task not by an overall reduction in investment expenditure, but by a reduction in certain types of investment expenditure inconsistent with the development plan. Such fiscal discrimination might discourage the flow of saving into less useful investment outlets, e.g., investment in land, real estate and certain well-established lines of commerce, and encourage the flow of savings into more useful investment outlets, e.g., industries scheduled in the development plan. On the former types of savings, higher rates of income tax may be imposed, while on the latter types lower rates or no rates of tax may be imposed, or in some cases subsidies may be granted.

It may also be deemed necessary to restrict imports of goods

which compete with similar home-produced goods in domestic markets. Thus indirect taxes, principally customs duties, may not only be employed to discriminate against unessential consumer goods in favour of essential capital goods, but also to afford protection to infant industries.

2. PUBLIC LENDING AGENCIES.

But it seems quite probable that a large portion of the new capital which becomes available in under-developed countries will be in the hands of their governments. Domestic savings will have largely been created by governmental policies lowering consumption relatively to production, or will have been diverted into the treasury by taxing profits and rents. It seems also probable that much of the foreign capital will be in the form of inter-governmental loans. This creates the danger that the greater part of the available capital resources will be diverted towards financing public undertakings, whilst private business will be relatively starved of capital. True, under-developed areas have a great need for investment in the public sector; but they have an equally great need for investment in the private sector, extra capital in the hands of small farmers and manufacturers. The danger may indeed be averted if the government uses some of the capital to finance institutions lending to private enterprise. Indeed most governments have already started farm credit

institutions and industrial development banks.

of primary production.

(A) Farm Credit Institutions:

Small farmers as well as handicraftsmen are usually financed in their peasant production through traders, and a vast amount of their capital is raised in this way. But traders lend on onerous terms; it was therefore a primary task of some governments to set up public financial institutions to lend capital to small farmers and handicraftsmen in replacement of this onerous way of money-lending. The government investigates their financial needs and lends them the required money. But the cost of borrowing in any case is rather expensive, whether it is effected through public lending agencies or money-lenders. However, this cost can be minimised if every village in the rural community establishes a co-operative credit society of its own, a society where everyone knows everyone else. In this way there will be no cost of investigation as to the credit status of the peasant borrowers, and there will be very small costs of lending proper. Where a co-operative marketing board has already been established, the function of money-lending can be coupled with the function of distribution. Such a wider scope of co-operation in marketing and finance would indirectly encourage thrift among the rural population. Furthermore, some of these co-operative societies will probably be amalgamated into district organisations and central federations. In this way they can easily get hold of

enormous sums of money and play a prominent part in the promotion of primary production.

But it is not sufficient guarantee of the security of loans granted by the co-operative societies to confine them to selected borrowers. Loans should not be given unconditionally to the farmers. This would be unwise. Each loan must be linked to a specific productive use, and there must be some sort of verification that the funds are used only for the purpose for which they have been contracted. In under-developed countries, however, the application of this idea of conditional lending is not an easy matter. If, for instance, a farmer needs to borrow a sum of money, which is apparently not linked to any specific productive use, he may find a way to get round this difficulty. For instance, he may secretly sell some of his livestock, and then apply for a loan on the false pretence of having to buy livestock. Failing this, his financial crisis may drive him to borrow from the money-lender on onerous terms.

Governments of under-developed countries, fully conscious of the abuses of money-lending, should refuse to recognise in the courts all mortgages and debts of money-lenders. But this being done, the governments concerned are under an obligation to create a lending organisation to take over the function of private money-lending for productive purposes. Moreover, the governments concerned should recognise the crises of life in the countryside, e.g., famines, droughts, deaths and weddings, which evidently require the acquisition of some financial resources. There should

be a device whereby farmers are to be ensured against such unforeseeable accidents of life. A system of social insurance on a national and compulsory basis would ideally serve this purpose.

The development of agricultural credit in Egypt is indeed an interesting case study. In view of the great importance of agriculture in the Egyptian economy and the predominance of small-scale farming, cheap short-term agricultural credit is more necessary than any other form. Yet until 1930 there was practically no institution specialising in agricultural credit.

Farmers obtained their requirements from different sources. Growers of sugar-cane, for instance, received advances from the Sugar Company. Growers of cotton were sometimes financed by local merchants or branches of exporting firms, in return for a lien on the crop. These merchants in turn often borrowed from the banks, so that the rate of interest charged to growers was relatively high. Small mortgage loans were also rendered inaccessible or expensive by the fact that the Credit Foncier confined itself to large loans. The bulk of credit requirements was supplied by village usurers, who charged rates of 30 or even 40 per cent.

In 1931 the Credit Agricole d'Egypte was founded with a capital of £E., 1,000,000, of which the Government supplied one half and the principal banks the other. The Government has, moreover, advanced £E., 3,000,000 at $2\frac{1}{2}$ per cent, reduced to $1\frac{1}{2}$ per cent in 1938, and guaranteed shareholders a minimum dividend of 5 per cent, in return for which it has control over the bank's

activities. The bank has been utilising the services of government tax-collectors for the collection of instalments. This and its rather bureaucratic methods have tended to keep away many of the smaller growers for whom the bank is principally designed, but have not prevented a remarkable development. At the outbreak of war it had nearly 5000 'shoonahs' distributed all over the country.

In 1938 the Bank sold on credit 173,000 ardebs⁽¹⁾ of cotton seed and 136,000 tons of fertilisers (about 25 per cent of the total consumption of seed and fertilisers in that year). The total value of such sales amounted to £E.,538,000. The bank's advances to growers and co-operatives for purposes of cultivation totalled £E.,919,000; and in addition £E.,695,000 was advanced against cotton deposited in 'shoonahs' and £E.,887,000 against crops. In addition to these short-terms the bank has also granted medium-term loans (up to ten years) for the purchase of livestock or machinery and for land improvement, etc. The total outstanding in 1937 was £E.,385,000.

The original object of the bank was the financing of small growers; but in view of the very reasonable rates charged - 6 per cent for individuals and 5 per cent (later reduced to 4 per cent) for co-operatives - big landowners sought increasingly to make use of its services by inducing it to advance loans to owners of up

(1) 1 ardeb = 5.444 bushels.

(1) 1 feddan = 1.822 ardeb

to 200 feddans ⁽¹⁾ instead of only up to 40, thus covering over 99.9 per cent of the landowners.

The effects of these measures on the development of co-operatives were so far-reaching that there has been a project for transforming the Credit Agricole into a co-operative bank. With the eagerness of peasants to obtain cheap credit and the zeal of officials to obtain results the number of co-operatives had by 1931 reached 539, with a membership of 53,000. But the foundation of the bank in that year, which advanced loans to individuals and co-operatives alike, removed the main attraction of the latter, and their rate of expansion slowed down considerably. In 1939 the number of co-operatives was only 793, membership 78,000, advances and sales £E1,125,000, and paid-up capital and reserves £E.,334,000. Nor did the matter end here. The fact that the Credit Agricole advanced to co-operatives at a lower rate than to individuals was best appreciated by large land-owners, who began to join the co-operatives and secure control over them.

The co-operatives have attempted to perform many services for their members: advances of short, medium and long-term loans, for seasonal finance or long-term improvements; sale of produce; purchase of household goods; encouragement of village industries, etc.

Nevertheless, there had existed so widespread a dissatisfaction with the results so far obtained that in 1940 a Commission was

(1) 1 feddan = 1.038 acres.

formed to study the defects and prospects of improvement of the co-operatives. Its main recommendation was the gradual transformation of the Credit Agricole into a Central Bank for co-operatives, which should restrict its activities to financing the societies. There can be no doubt that such a measure would give a great stimulus to co-operation. But there remain several important obstacles: first, the peasants' ignorance and imperfect appreciation of the benefits of co-operatives; secondly, the baleful interference of government officials in the affairs of the co-operatives; and thirdly, the influence of large landowners who secure control over the societies and prevent the emergence of a democratic co-operative spirit.

Under Law No. 139 of 1948, the Statutes of the Credit Agricole d'Egypte were amended to enable it to assume the functions of a co-operative as well as an agricultural credit bank. The project for the creation of a separate co-operative bank was thereupon dropped. The capital of the bank was increased from £E.1 to £E.1½ millions in 1949. The functions of the bank include the grant of advances for costs of cultivation, harvesting and purchase of agricultural machinery, livestock, etc., and the financing of land reclamation, advances on crops, sale of fertilizers, seed, etc. The Government is authorised to guarantee a minimum dividend and to advance to the bank loans of not more than £E, 6 million at rates of interest to be determined by agreement between the bank and the Government, which cannot claim repayment before the

liquidation of the bank. All the bank's advances and loans have the first lien on the proceeds of the sale of the produce of the year for which the loans are contracted. Advances by the bank to cultivators and co-operative societies totalled £E.,13,563,000 in 1950, compared with £E.,9,076,000 in 1949.

(B) Industrial Development Banks:

The facilities afforded by banks in most of the under-developed countries fall short of present needs of industrial development and a priori will fail to cope with any future expansion. Credit institutions in those countries may have competent staffs for dealing with staple trades in primary products both at home and abroad, but they do lack experience and expert knowledge for studying the needs and investigating the financial standing of the industrial concerns.

In those countries, no specialised institutions exist for granting intermediate or long-term credit to industry. The need for a special institution for granting intermediate credit is most acutely felt in such countries where the majority of industrial firms are of a relatively small size and cannot afford the large cost of a capital issue. It is for this reason that the establishment of industrial development banks has been advocated to provide long term and intermediate credit for industry, catering for the needs of small and medium size firms.

The Industrial Bank of Japan, for instance, was established by the turn of the century with a view to providing finance for

state enterprises and some other key industries. It actually was instrumental in developing shipbuilding, transport and other home industries, and in carrying out the policy of compulsory cartellisation and financial assistance to depressed industries. The Industrial Bank of Egypt was formed in 1949 with a capital of £E.1,500,000 with the object of developing Egyptian industries by participating in the establishment and consolidation of industrial companies, assisting in the supplying of raw materials and machinery, furnishing short, medium and long-term loans, etc. The Egyptian Government holds 51 per cent of the shares and the balance was subscribed by Egyptian Chambers of Commerce, and by some of Egypt's principal industrial concerns.

Even in an industrially advanced country like Great Britain the idea of industrial development banks is not unfamiliar. In this country banks have traditionally refrained from having close connections with industry, and except for some medium term credit to a select group of customers, their role has consisted in providing short term loans and in financing international movement of goods. But the prolonged depression in basic industries and chronic unemployment in "Special" areas called for the adoption of some radical methods of financing industry, since the existing channels, i.e., banks and the investing public, were reluctant to throw good money after bad. Hence a break with tradition was initiated when the Bank of England set up two subsidiary companies: Bankers Industrial Development Co. and Securities Management Trust

to preside over the re-organisation of basic industries and provide them with funds for the construction of new works and modernisation of equipment. Financial help to depressed industries was normally contingent on their acceptance of measures of compulsory cartellisation and sometimes entailed formation of mergers and closing down of "redundant capacity". Both companies were in fact engaged in salvage work and were not concerned with financing of new industry proper. In February 1940, the B.I.D.C. ceased to function as a credit institution. In January 1945, however, the Treasury announced its plans for postwar financial assistance to industry, and two finance companies have since been established: The Finance Corporation for Industry and the Industrial and Commercial Finance Corporation. Their object was to be an addition to existing channels of finance, especially where a market issue cannot be made or the amount required puts the operation outside the scope of normal capital issue channels.

It is worthy of note, in this connection, that most governments of under-developed countries have already entered the sphere of agricultural and industrial finance by establishing farm credit institutions and industrial development banks. But neither of these has anywhere received a fraction of the amount of money which is really needed to increase agricultural productivity and to foster manufacturing industry in the economy. Thus any expansion of the funds at the disposal of these credit institutions lending to private enterprise should be a main feature of economic development.

With respect 3. EXTERNAL SOURCES OF CAPITAL.

The ability to have large exports and obtain favourable terms for them is of tremendous importance for all under-developed countries. It is of particular importance to countries in whose economies international trade plays a large part.

If the proceeds of exports are substantial and stable, such countries may be able to satisfy their needs of imports of capital goods for development largely out of these proceeds, and thus to keep down the volume of borrowing. This may also make it easier for them to make replacements in later years. Besides, a favourable balance of payments position may have its effect in easing the terms and conditions on which external capital may be obtained. Favourable and stable terms of trade are thus of prime importance to those countries. In this respect, however, their position is traditionally precarious and vulnerable. Primary commodities are the main items of these countries' exports; and for reasons well explored in economic analysis, such primary commodities, particularly industrial raw materials, are open to violent price fluctuations. Nor can the fall of primary commodity prices be compensated for by an increase in the volume of exports. Often the effects of changes in quantities are added to those of changes in prices, with the result that the values of total exports may vary from year to year as much as 30 per cent. Changes in the same direction may also go on for successive years, resulting in a total fall in value of more than 50 per cent within a few years.

With respect to the terms of trade, the authors of a United Nations Report have drawn attention to the unfair policies of some developed countries, which depress the terms of trade of under-developed countries and hold up their economic development. First, some developed countries undertake to subsidise domestic production of some commodities which might be produced mainly by under-developed countries. Beet sugar production in U.S.A. and Europe is a case in point; other affected commodities are meat and wool. Moreover, some industrial countries even export primary commodities which they produce in competition with under-developed countries. Such a commercial policy reduces the opportunities of the latter countries to expand in such fields of production, moves the terms of trade against them, and contributes to the disequilibrium of world trade. There is also the risk that capital goods may not be available in time at the crucial stages of the operation of development plans. Such a risk, the authors stress, has to be eliminated, and countries economically under-developed have to be given an equitable share of the capital goods and other materials that are needed for the execution of their planned development.⁽¹⁾

The authors have estimated the total capital, which is required by under-developed areas in order to raise their average national incomes by 2 per cent per annum, to be around \$19 billion, i.e., 20 per cent of their national incomes in 1949.⁽²⁾

(1) United Nations Report, op.cit., Sections 230, 231, 234, pp.73-74.

(2) C.f. Statistical Appendix, p.527.

This annual investment, they hold, might raise their national incomes by about 2.5 per cent per annum. But this is not the amount by which their standard of living will increase, for their populations are growing rapidly and the population growth will absorb some of the increased income. In the same year, domestic savings fell short of what the estimate requires by nearly \$ 14 billion. But under-developed countries need not import as much as \$ 14 billion annually because their domestic savings might be increased by adopting measures requiring domestic action; and because, if this investment took place and raised national incomes to as much as 2.5 per cent per annum as estimated, some part of the increase in national income could be mopped up to increase domestic savings. When allowance is made for these two possibilities, it remains that a 2 per cent increase in national incomes per head cannot be achieved unless capital resources in excess of \$ 10 billion are brought annually into under-developed countries.

It is to be noted here that the investment target of \$ 19 billion per annum shows the capital required by the under-developed countries of the world for two purposes: to increase the national income by transferring population out of agriculture into non-farm occupations, and to increase agricultural yields. The capital needed for industry is estimated by the authors to be a little over \$ 15 billion whereas the capital needed for agriculture is estimated to be a little less than \$ 4 billion in order to raise national income per head by 2 per cent per annum. The

comparison between these two figures may show the importance of the provision of new employment outside agriculture, which is commonly called for short "industrialisation". Although this process of industrialisation may vary from country to country in accordance with the pressure of population and the prospects for improving agricultural yields, it is everywhere of the highest priority, whether because of the superior productivity of industry, or because the improvement of agricultural techniques will reduce the need for labour, or because the land is already overcrowded.

It is to be noted, too, that the authors' estimate of the investment target in under-developed countries as being \$19 billion per annum is in fact based on two important assumptions. First, it is assumed that the annual transfer out of agriculture into employment other than in agriculture is 1 per cent of the total working population. Secondly, it is assumed that \$2,500 represent the amount of capital required for each person absorbed into non-agricultural employment. This is an average, the authors say, which takes into account the low amounts required by those who go into light industries, and the very high amounts required in heavy industries and in public utilities. It also includes expenditure on industrial research and on training. This gives the figure of \$15 billion a year for the under-developed world as a whole, of which 70 per cent is shown by the authors to be required for Asia.

It should also be noted that the authors' estimates include

only what is directly required for industry and for agriculture. The total capital requirement, including the capital required for social overheads, greatly exceeds \$ 19 billion. Compare this figure with net investment in the United States of America, which now runs at between \$ 25 and \$ 30 billion a year for a population one-tenth the size of that of the under-developed areas, and for an economy that is already highly developed. Another point which is worthy of mention is that the cost of industrialisation, as a ratio of the national income, varies inversely with national income per head. Industrialisation requires a larger part of the national income in poor countries than it does in rich countries, because as between countries the cost of industrial capital per worker does not vary very much. (1)

In view of these large investment requirements which, according to the authors of the Report, are not beyond the capacity of the developed countries to provide, it is of great importance to consider how the inflow of capital might be increased.

(A) Private Investment:

In respect of private foreign investment, the authors seem to hold a rather pessimistic view. In the past decades, private purchases of foreign government securities, i.e. 'portfolio' investment, as distinct from 'direct' foreign entrepreneurial investment, constituted the largest type of foreign capital. It has now virtually ceased for European investors are sometimes

(1) United Nations Report, op. cit., pp. 75-79.

prohibited by their respective governments from undertaking foreign lending. The New York market, moreover, has still not recovered from its shock in the 1930's, when some governments defaulted payment on their borrowings in the previous decade. At present it is but a matter of speculation to estimate the demand and supply of this type of foreign investment. On the demand side, it is very likely that the demand for this type of capital may not be large simply because the borrowers with the best credit alone could look forward to borrow more cheaply in the open market than they can borrow from the Export-Import Bank, or from the International Bank. On the supply side, individual investors are no longer likely to be interested in such a type of foreign investment. True, institutional lenders, e.g. banks and insurance companies have superseded individual lenders in importance in the capital market; but even as far as institutional lending is concerned, the United States Government forbids investment in foreign securities.⁽¹⁾

Practically all the private foreign investment now taking place is direct investment in branches or subsidiaries effectively controlled by the capital-exporting countries. In recent years, the experts have estimated that about 70 per cent of direct investment has been going to petroleum, and very little foreign investment is taking place outside the oil-bearing countries.

Many obstacles indeed stand in the way of the further

(1) Ibid. p. 80.

expansion of private foreign investment. Some under-developed countries, for instance, do not favour this type of investment for they fear foreign control of the important sectors of their economy, and they resent the high cost of foreign private capital. This is the reason why at present opportunities are denied to foreigners. Public utilities which used to be the most attractive private foreign investment in many backward areas are now being reserved to domestic private enterprise, or else are being operated under public control. Besides, foreign companies are often denied the opportunity of leasing land for agricultural production; and even mining is sometimes reserved to domestic entrepreneurs or the state.

The second obstacle in the way of foreign private investment is the fact that some governments of capital-importing countries impose arbitrary acts which might frustrate the security of foreign investment. A third and more serious obstacle is that capital-importing countries cannot guarantee that foreign investors will be allowed to remit their profits home in foreign currency or to retire their investments, simply because it is beyond the power of those countries to ensure that necessary foreign exchange will always be available.

Finally, some foreign investment is held back by the existence of double taxation. It is therefore to be hoped that the governments of capital-exporting countries will provide legal exemptions from double taxation of profits earned abroad, and that

the governments of capital-importing countries will enter into agreement with other governments concerned in order to provide for the protection of foreign investments. (1)

(B) Governmental Lending:

At present there are two main sources of foreign lending, namely the United States Export-Import Bank and the International Bank for Reconstruction and Development. The loans of the Export-Import Bank were at one time confined to Latin America; but they are now being made available to all countries.

And The International Bank, it is reported, has been lending to under-developed areas at a rate well below \$ 300 million annually and expects not to exceed that figure in the next few years. At the beginning it was feared the Bank would not be able to borrow enough money to lend on the required scale; but it has lately succeeded in making its issues acceptable in the capital markets. Then the Bank was bound by a narrow interpretation of its articles of agreement, which seemed to confine it to lending sums of foreign exchange needed to purchase equipment and materials for specific projects. In the opinion of the authors, although the articles seem to be more liberally interpreted, there is still the impression that the Bank attaches great importance to the foreign currency aspects of development. What is really important, they say, is to build up the capacity of under-developed countries to

(1) For detailed study see Royal Institute of International Affairs, The Problem of International Investment, London, 1937.

produce goods and services, and the Bank should start from this point rather than from a measurement of currency needs. If development succeeds, the transfer problem of meeting the debt charges should take care of itself. ⁽¹⁾

Even apart from these technical difficulties in the way of economic development, a further obstacle to greater lending by the Bank is the unpreparedness of the governments of most under-developed countries. Some of them may not show the desire to develop their economies or understand adequately what is involved. And, even if there is the desire to make rapid progress, lending may be slow, for some borrowers lack the facility to absorb imported capital rapidly. They may lack the technical staff to make surveys and prepare concrete plans, to construct capital works and to operate large new undertakings. The Bank has started to meet this difficulty by sending out its own survey missions and by giving technical assistance in the preparation of plans.

A further obstacle is the fact that the amount that can profitably be invested at a 4 per cent rate of interest depends on the amount which is being spent at the same time on providing social capital, e.g., public health, education, roads and communications. There is much to be done in this way before under-developed countries will be in a position to absorb large amounts of loan capital.

⁽¹⁾ This discussion of governmental lending, however, should raise

(1) United Nations Report, op. cit., Sec. 266, p. 83.

the basic need for a more objective approach to international co-operation. Frankel, in this connection, has emphasised that not only is the revival of private investment desirable, as is generally agreed, but that decisions by such international agencies as the International Bank must themselves increasingly be freed from political pressures which make economic criteria of investment impossible to apply, either before, or after, the investment decision is made. "Investment involves a continuing process of decision-making," he says, "it involves enterprise per se, and it involves therefore the recognition of the need for a large variety of institutions able to conduct it according to evolving international law or custom, and free from interference as long as such law or custom is adhered to. Without the human agencies able to conduct continuous economic operations, unhampered by fiscal or other exactions foreign to their purpose, the growth of capital in any form is impossible; and foreign investment becomes a farce however much this may be camouflaged. This is especially true of investment in under-developed areas where the experience and aptitude for modern enterprise and the fashioning of administrative devices for its social control are so recent."⁽¹⁾ In Frankel's opinion, therefore, it might prove very valuable if institutions like the International Bank were given the opportunity to develop agreed comparative criteria of world investment, criteria

(1) S. Herbert Frankel, *op. cit.*, pp. 80-81.

(1) United Nations Report, *op. cit.*, Section 20.
 (2) Partners in Progress, A Report to the President
 Development Advisory Board, U.S. Government.

which would be applied continuously as a code of international conduct relating to the investment itself, and recognised by national governments as such.

Apart from the need for a more objective approach to international co-operation, the authors even feel that the International Bank has not adequately realised that it is an agency charged by the United Nations with the duty of promoting economic development. In their judgment, the bank "should do everything that lies in its power to break down the obstacles to sound investment in the under-developed countries. The Bank should set itself to reach, within five years, some such target as an annual rate of lending of not less than \$ 1 billion a year to the under-developed countries. If it shows no sign of approaching this target, the whole question of the proper international organisation for the provision of adequate amounts of loan capital to the under-developed countries should be reviewed by the United Nations."⁽¹⁾

It has also been proposed that, since the International Bank cannot make equity investments and some companies cannot raise all the equity capital they need for making direct foreign investments, an International Finance Corporation should be established "with authority to make loans in local and foreign currencies to private enterprise without the requirement of government guarantees, and also to make non-voting equity investments in local currencies in participation with private investors."⁽²⁾

(1) United Nations Report, op. cit. Section 268, p. 84.

(2) Partners in Progress, A Report to the President by the International Development Advisory Board, U.S. Government Printing Office, March, 1951, p. 84.

(C) Inter-Governmental Grants:

As has been pointed out, governments of under-developed countries will have to spend large sums in improving the human factor in development before rapid economic progress can begin to be made. So they will have to spend large sums on education, on public health, on agricultural extension services and on basic social capital. Most of these countries lack the money required for these purposes and they cannot borrow it. Without this money, however, development can only proceed at a slow rate. It is for this reason that experts recommend the creation of some mechanism for transferring sums of money from the developed to the under-developed countries by way of grants-in-aid. The principle underlying a mechanism of this sort is based upon the idea that the rich should help the poor on an international scale. The desirability of such transfers need not be questioned, at least so long as they are compatible with the maintenance or, better still, expansion of world income. Besides, we need not entertain any exaggerated notions about the size of such income transfers. Let us only remember that 2 per cent of the United States' national income would be equal to about 7 per cent of the combined national income of all low-income countries outside the Soviet orbit.

The post-war years have witnessed the beginnings of a system of international income transfers. As a result of closer contact and communications, people in the United States have become increasingly conscious of the discrepancies in living standards, of the hunger, poverty, disease

and illiteracy that prevail in two-thirds of the world. The humanitarian aspects of Point Four have been associated with an emotional tone in the reports and official publications concerning these problems. Both the Gray Report of November 1950⁽¹⁾ and the Rockefeller Report of March 1951⁽²⁾ came out in favour of a sizable flow of governmental grants from the United States to the low-income areas of the world as part of the foreign aid programmes of the United States.

In the past, international unilateral transfers may have occurred to some extent under the guise of foreign investment. It has been argued that foreign investments have, in part, turned out to be haphazardly distributed gifts, because of subsequent default. But this is a very awkward solution since default interferes with the continuity of the flow. Default is therefore considered unwise and immoral.⁽³⁾

Again we encounter the basic pressures that make for income transfers from rich to poor when relatively advanced countries are associated with economically backward areas in the form of colonies. In Western European countries in the last two or three decades it has been a fashionable question to ask: do colonies pay? The answer of the experts has usually been in the negative. Recent

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- (1) A Report to the President on Foreign Economic Policies, U.S. Government Printing Office, November, 1950.
 - (2) Partners in Progress, A Report to the President by the International Development Advisory Board, U.S. Government Printing Office, March, 1951.
 - (3) Ragnar Nurkse, op. cit., p. 79.

(1) Ibid. pp. 73-80.

colonial history seems, on the whole, to support this view. For instance, M.M. Knight, the American economic historian, finds that in Algeria the local government's budget deficits were covered directly by the French Treasury and that the framework of a system of railways, roads and ports was laid down as an outright gift from the French taxpayer.⁽¹⁾

Quite apart, however, from the humanitarian, or the inconvenient but inevitable, aspects of international gifts and grants, do such transfers provide a sufficient and satisfactory solution to the problem of capital accumulation in under-developed areas? International grants can of course be used for capital formation in the same way as loans. In the case of loans, however, there is generally some pressure to use them at least for specific productive purposes so that interest and amortization requirements can be met later on. But in the case of grants, even this pressure does not exist. Grants can be used directly or indirectly for consumption without any subsequent inconvenience. But while a country's capacity to absorb foreign aid for current consumption is presumably unlimited, there exist fairly definite bounds to absorptive capacity if the aid is to be applied to capital formation. They arise from a country's backwardness itself and from the lack of various overhead facilities in the early stages of development. Capital development schemes usually require large movements of people as well as of material goods;

(1) Ibid. pp. 79-80.

but in under-developed areas, mobility is impeded by lack of transport, housing and public facilities of all kinds.

Such local bottlenecks that limit a country's absorptive capacity for investment purposes tend to accentuate the general difficulty of ensuring the productive use of external resources. The earmarking of particular foreign loans or grants to specific investment projects may do something to ensure the productive use of funds, but it is not by any means a basic remedy. As Nurkse has pointed out, only where there is no domestic saving at all to start with can such earmarking be fully effective. It is not otherwise an infallible method of increasing the rate of investment, for it cannot prevent a substitution of external for domestic sources of capital. Under the European Recovery Programme the specific project approach was followed to some extent in the release of counterpart funds for reconstruction and new investment projects. But as an illustration of the futility of the specific project method of control the following story has been told by the same author. "The Austrian government," so the story goes, "asked for the release of counterpart funds to reconstruct the Vienna opera. The E.C.A. is said to have replied that this would not be a productive investment and that the release could not be granted for this purpose. Then the Austrian government remembered that it was itself financing the construction of an electric power plant in the mountains. It went back to the E.C.A. and asked for a release of counterpart funds to pay for this piece of construction, to

which the E.C.A. agreed. So all that happened was a switch: the wily Austrians, having got the E.C.A. to take over the financing of the power plant, now financed the reconstruction of the opera from their own resources."⁽¹⁾

The desire of the lending or giving country to tie its aid to specific investment projects is understandable, but this procedure by itself cannot assure the desired effect. The European Recovery Programme was first and foremost an investment campaign. "Much can be learned from it," says Nurkse, "in regard to the international financing of capital formation, but its main lesson is the vital need for plans and policies designed to make sure that top priority is given for capital formation in the over-all allocation of available resources, domestic as well as external. The American E.C.A. was insistent from the start that American aid should be matched by the greatest possible mobilisation of domestic resources in the receiving countries. In fact, under this programme the domestic resources used for capital formation in Western Europe as a whole were several times greater than the amount of American aid."⁽²⁾

The authors of the United Nations Report, in this connection, have formulated a comprehensive plan for the establishment by the United Nations of an International Development Authority with power to make grants to the governments of under-developed countries. Its main functions are the following:

(1) Ibid. pp. 95-96.
 (1) Ibid.

- (a) Decision upon and administration of the distribution of grants-in-aid for certain specific purposes listed below and to verify their utilisation.
- (b) Co-operation with under-developed countries in preparation and co-ordination of plans of economic development by affording general assistance and, where necessary, by providing the services of technical experts and by giving grants for the preparation of plans.
- (c) Assistance in implementing development plans, especially in the procurement of scarce resources, e.g., capital goods and technical personnel.
- (d) Making periodic reports regarding the preparation and progress of plans of economic development.

The following purposes are considered by the authors as eligible for grants; other purposes, which are capable of being self-supporting, should be financed by borrowing:

- (a) Research and education. This includes grants for agricultural extension services, technical schools, farm schools, local universities and for training technicians abroad, grants to departments of governments, research institutes or universities, wherever located, working on problems of under-developed countries;
- (b) Public health programmes, emphasising preventive medicine and nutrition rather than curative medicine;
- (c) Subsidisation of medium and short-term farm credit;

(d) Improvement of rural public works. This includes grants for roads, rural water supplies, land reclamation, drainage, soil-conservation, and afforestation.

The authors considered whether there should not also be created an institution to make loans at very low rates of interest for investment in social capital in general, e.g., roads. They have concluded that this is not necessary, since exactly the same purpose can be met by combining a loan from the International Bank with a grant-in-aid from the International Development Authority, in cases where an undertaking desirable on social grounds, could not meet the full burden of loan finance.

Besides, the authors have drawn attention to the great importance of the time factor in the process of economic development. Even if the authors' recommendations in respect of external, technical and financial assistance were all put into operation, they are still conscious of the fact that it would be some years before the rate of the flow of capital into the under-developed countries reaches a satisfactory level. The rate of expenditure of grants may be slow at first, because it takes much time to prepare plans for spending money and to assemble the persons who are required for carrying out the plans. Besides, the growth of private investment and loan capital will lag behind the expenditure of grants. The authors, moreover, lay much emphasis on the need for social and legal changes and for education and intensive training of industrial workers and technicians, which require minimum outlay on social overheads before rapid economic

development can begin. Time and money are also needed to obtain statistical data and to prepare development plans. Planning takes time. It is therefore essential that this period of initial preparation be cut down as far as possible, and the authors recommend that the proposed international development authority take steps to shorten this period.

In framing their recommendations regarding international measures which are, in their opinion, necessary and practicable in the sense that they represent the minimum required in view of the magnitude and the urgency of the problem, and in the sense that they are well within the capacity of the advanced countries, the authors are, however, well aware of the political difficulties standing in the way of their implementation. Meanwhile, they realise that from the viewpoint of under-developed countries the following question is of utmost importance: What is the extent of external aid on which these countries can count in drawing up their development plans? In their opinion, however, international action may be held up for different reasons and no definite answer can be offered in the existing international situation. Even so, under-developed countries cannot afford to delay action. The authors well recognise the urgency of the problem, and call upon those countries to proceed immediately with formulation of plans and their implementation. In fact many of them would find it best not to count on any substantial external aid. "It cannot be denied," the authors say, "that most of the under-

developed countries will find it extremely difficult to make progress in the initial stages without effective international aid. Even with such aid, their task would be difficult enough. As we visualise it, economic development of these countries will require fundamental changes in their social and economic structure, a large effort at mass education, and very intelligent husbanding of resources. This arduous task would be rendered more manageable if some external aid in terms of personnel and finance were available. In its absence, the task would indeed be formidable. Its essential nature would not, however, be changed; it would only call for a greater intensity of effort in all directions. The need for social cohesion and solidarity would be greater than ever, for the sacrifices imposed on the people by the initiation of the process of development would be larger and the period for which they have to wait for its fruits longer. It would call for great ingenuity in adaptation, in seizing all opportunities, making all economies, however small, and in quickening the pace of the whole process. The situation will make enormous demands on intelligence in planning, honesty, and ability in execution, and on discipline within the community."⁽¹⁾

(1) United Nations Report, op. cit. pp. 88-89.

CHAPTER 22.

ARE SOME TYPES OF ECONOMIC ACTIVITY
MORE IMPORTANT THAN OTHERS?

1. THE FOUR PROPOSITIONS.

Bottlenecks in economic development are not only confined to social, legal, administrative and financial problems, but problems no less difficult and exhaustive are involved in choosing the targets for the development programme, in formulating and putting it into operation.

As far as the proper disposal of the community's resources between various types of economic activity, i.e., the objectives of the development programme, are concerned, the marginal principle of the 'little more' and the 'little less' well-known in economic analysis can hardly apply in planning economic development in under-developed countries. Major structural readjustments are inevitably essential even though they do involve difficulties in the assessment of cost and productivity. It is for this reason that planners in under-developed countries have to fall back upon their qualitative judgments to choose between consumption and investment, or human investment or investment in material goods, or free trade and autarchy, or public works and other types of investment, or industry and agriculture.

It would be wrong, however, to give the impression that the problem in each case is that of choosing between one type of

activity and another. Progress must be made on all fronts simultaneously and in a balanced way. The problem in each case is only that of relative emphasis. Nevertheless, one might put forward the following four propositions in respect of priorities in general: (a) In the case of a stagnant economy, its revival should be the top priority, and this can be achieved by treating the economy to foreign trade; (b) In under-populated countries, concentration on increasing food supplies should be the guiding policy; (c) In over-populated countries, more emphasis should be laid on industry rather than on agriculture, exporting manufactured goods in return for food imports; (d) Whatever the condition of the area may be, expansion of those industries which earn or save foreign exchange should be the top priority, for the shortage of foreign exchange is one of the major difficulties in the way of economic development. The second and third propositions in the above list of priorities, however, have seemed to arouse much interest and controversy in many under-developed countries. It is therefore worth while to refer to such misconceptions as may arise in the minds of planners in those countries in so far as the relative emphasis of industry and agriculture in the formulation of development plans is concerned.

2. INDUSTRIALISATION OR AGRICULTURAL DEVELOPMENT?

So far the whole discussion has been general in character, not related to any particular country or countries. However, as we turn to consider the question of priority as between industry

and agriculture, it is impossible to go on without making at least a broad distinction between two types of countries, roughly described as 'overpopulated' and 'under-populated'.

With reference to the two possible views on the relationship between population and capital formation, it has been pointed out that domestic resources can be mobilised in a country where there is much surplus labour on the farms. Population is viewed as a possible source of supply of capital. The other view stresses population size, as well as population growth, as a factor governing the total amount of capital required. A large population needs a large amount of capital and an increase in population calls for an increase in capital. The second view is apt to emphasise the need for investment, domestic and foreign, in order to offset the adverse effect of population growth on consumption per head and also to provide a possibility for increasing income per head, i.e., both extensive and intensive investment.

These two approaches however, do not exclude each other, and neither of them is likely to be universally valid. If the first approach applies to the densely populated peasant economies, it may be that the second is more applicable to sparsely populated areas including, for instance, South America. It might seem paradoxical, Nurkse remarks, to suggest that such regions as those of South America, which, on the whole, have a higher level of income per head, are more dependent on foreign assistance than the

overcrowded peasant countries. It is not a conclusion worth emphasising for practical purposes. It is based only on the rapid rate of population growth coupled with the absence of disguised unemployment on any mass scale.⁽¹⁾

In discussing the question of priorities in under-developed countries, however, it might be suggested that a transfer of people from the 'unproductive' to the 'productive' occupations seems to be the solution, but it completely begs the question of capital supply. The main reason for this difference in productivity as between different occupations may be that in the one little capital is used, while in the other, production is relatively capital-intensive. In particular, this may be one reason for the difference stressed so much in under-developed countries between the level of productivity in agriculture and in industry. It is not so much that agriculture is inherently less productive than industry, as is sometimes thought, although demand conditions, and other circumstances as well, do create important differences between the two types of productive activity. There exists apparently a statistical correlation between the degree of industrialisation and the level of average income in different countries, but from this it is not legitimate that the former causes the latter. The two things may both be due to a third factor: namely, the supply of capital. Modern industry is highly productive because it uses a lot of capital. In

(1) C.f. Ragnar Nurkse, *op. cit.* p. 50.

advanced industrial countries labour has the immense advantage of being supported by a great deal of capital, in agriculture as well as in manufacturing industry. For an under-developed country a transfer of labour from agriculture to industry is, by itself, no solution, for it does not by itself provide the capital necessary for industry. The problem of capital formation must be solved first. (1)

The productive use of the rural excess labour in the densely populated countries seem to provide at least a partial solution of the problem of capital formation, for it is possible to get more capital from domestic sources by drawing labour away from agriculture without a cut in consumption. The same solution may be conceivable for the sparsely populated countries, but not without a radical improvement in the techniques and methods of agricultural production. This is indeed a pre-condition of industrialisation in sparsely populated countries where conditions for an advance in farming techniques are favourable at least inasmuch as land, by definition, is relatively plentiful. In those countries an increase in agricultural productivity must have top priority over everything else. The reason for this is that the great majority of the population, even in the sparsely populated areas, is in agriculture. If labour is wanted for capital formation, agriculture is the place to look for it. Moreover, in agriculture some increases in productivity are

(1) Ibid., p. 51

possible that do not require much, if any, capital. There is the possibility of applying improved knowledge in seed selection, soil conservation, crop rotation, the use of fertilisers, livestock feeding, fighting insect pests etc. In a great many ways, a great deal could be done, and is now being done, that does not require heavy capital investment.

But in densely populated countries, a substantial improvement of agricultural technique can come perhaps only as a result of industrial development. In sparsely populated countries, by contrast, an improvement in agriculture is the pre-requisite for capital formation and industrial development. This conclusion is well stated in the United Nations Report thus: "In a country where there is no surplus labour, industrialisation waits upon agricultural improvement. The way to industrialisation lies through the improvement in agriculture The reverse is the case in a country where population is so large in relation to cultivable land, that the land is carrying more people than can be fully employed in agriculture substantial technical progress in agriculture is not possible without reducing the numbers engaged in agriculture."⁽¹⁾

In the two cases of overpopulation and underpopulation there is one thing in common, there is an increase in total output: in the one case it occurs through the use of previously unemployed labour, in the other through technical improvements in

(1) United Nations Report, op. cit., p. 59.

agriculture. Common to both is also an increase in farm productivity in the sense of output per worker engaged in agriculture, even though in the first it comes about through a withdrawal of excess labour rather than an advance in agricultural techniques. In both cases, too, the problem of saving is the problem of channelling as much as possible of the increment in total output into capital formation. It is not a matter of cutting down consumption. To keep a firm check on the rise in living standards should be easier than actually to reduce the level of living. Yet it is hard enough, in view of the forces pressing for higher immediate consumption.

A possible difference that appears from the consideration of the two cases is that, as far as the prospects and potentialities of domestic capital formation are concerned, overpopulated countries might be better off, because they have a large surplus of unused labour that could be set to work on capital formation. The thinly populated countries do not have the surplus population that could be used for capital construction; they are faced with the prior problem of having to create the surplus labour through improvements in agriculture. In other respects, however, the latter countries are better off. Many of them have a higher average income to start with. The very fact that they have much land in relation to population should tend to provide more scope for increased productivity in agriculture. And in any case, the mere possession of a surplus labour force in the over-populated

countries is no guarantee of progress. It is an advantage only if, and in so far as, the surplus labour force can be effectively used for real capital accumulation. (1)

3. SELECTION OF INDUSTRIES.

Development planning, as far as priorities are concerned, should not only be viewed from the angle of the relative emphasis in respect of agriculture and industry in under-developed countries, but also from the angle of the relative adequacy of different manufacturing industries in any development programme. In other words, we are not here primarily concerned with the choice between primary and secondary production as being of top priority, but rather with the choice as between different lines of economic activity in secondary production. Manufacturing industries indeed vary widely in their requirements of power, skill, capital, heavy raw materials, and so on, and each country must be careful to make the most appropriate choice. Nevertheless, an attempt can only be made to indicate some broad criteria for the selection of industries in the formulation of any development programme. The problem of selection should of course involve considerations of demand and cost factors in the process of industrialisation.

Let us first assume that the provision of capital in some way or another brings about a certain rate of industrial expansion, an increase in real income and a consequential steady increase in market

(1) Ragnar Nurkse, op. cit. pp. 55-56.

demand. Then such an increase is presumably distributed over various industries, and hence the new selling possibilities created by the expansion of the domestic market would then be taken as a provisional guide to the direction of industrialisation. But this demand criterion may or may not conflict with the traditional doctrine of comparative costs which lays down that each country should produce those commodities which it is best suited to produce and dispose, through the channels of foreign trade, of that part of its output which is surplus to home requirements.

However, there is a wide range of industries where the demand criterion could be applied without question. This is the case with the so-called 'sheltered' industries whose products do not normally pass through the channels of foreign trade, e.g., road-making, housebuilding, retail trade, the generation of electricity and other kindred industries. This is also the case with the existing export industries provided that costs are not pushed up through their expansion and that world demand conditions remain unaltered. In so far as these industries are concerned, it may be assumed that the country concerned has a comparative advantage and in the face of an increased home demand, it would therefore be justifiable to expand them.

It is only in the remaining field of non-specific products, i.e., products which are imported in whole or in part, or goods which are so far not produced in the country owing to the lack of demand for them, that the demand criterion alone could not be taken to be a

decisive guide. The comparative cost doctrine would seem to provide the additional criterion. But as far as the long run view is concerned, the state could foster the development of those industries which do not improve their immediate competitive position, but in which the actual disadvantage is smallest, or is expected to turn into a smaller disadvantage or into an actual advantage in the near future. In other words, output plans would be based on prospective costs on the assumption that costs will in fact be different in future, under the influence of deliberate policies. However, estimates of what costs will be in future are little more than guess work, and the relevant decisions are necessarily arbitrary.

Nevertheless, it is possible to make a few generalisations in respect of the probable lines of industrial development in under-developed countries. To start with, unskilled labour is relatively the most abundant and hence the cheapest factor. This being given, it is naturally in the so-called 'light' industries, i.e., industries which are labour-intensive, that industrial development could be started; and, particularly in those industries in which mechanisation involves a reduction in skill requirements that capital equipment will be increased and improved, e.g., textile industries and the boat and shoe industry. As a general rule, some consumption goods industries, which are included among the 'light' industries, will develop first. Apart from mining, buildings, public utilities, repair and assembly, capital goods as well as certain consumption goods industries, e.g., drink and tobacco, which are included among

the 'heavy' industries will expand only at later stages.

Although this sequence has been observed throughout the history of industrialisation, the high capital or skill requirements of the 'heavy' constructional industries may not check their development at the initial stages, provided specific conditions do exist. They may enjoy cost advantages owing to their proximity to rich sources of raw materials, or they may from the beginning find a market outside manufacturing, e.g., in an expanding agriculture or in mining, or if a country fears that it will not be able to obtain a steady and continuous supply of capital goods required for its development. But apart from such exceptions, it is only in the course of time that productive skills can be developed, and more capital-intensive techniques of production or industries requiring higher capitalisation will come into the range of profitability.⁽¹⁾

(1) K. Mandelbaum, *The Industrialisation of Backward Areas*, Institute Of Statistics, Monograph No. 2, Oxford, 1947, pp. 11-16.
See also Maurice Dobb, *Some Aspects of Economic Development*, Delhi School of Economics, Delhi, 1951, p. 34, seq.

CHAPTER 23.

PLANNING IN PRACTICE.

As far as the techniques of planning are concerned, once the objectives of the plan have been set out, the next task of the planners is to formulate the development plan and put it into operation. In this respect, the first step is to establish technical survey organisations to find out what resources are available. Geological, biological, and engineering surveys and market surveys are needed, first of all, before the country is in a position to begin development planning. In addition to technical surveys, economic surveys should also be undertaken. Two further steps must be taken for this purpose. The first is the survey of all economic institutions which can stimulate and mobilise domestic savings, the survey of the existing commercial law which can inspire the confidence of people, and the survey of the scale of organisation of business units, whether they be in agriculture, industry, commerce or services of marketing and transport. The second is the formulation of manpower budget as well as similar budgets showing the magnitude and utilisation of the scarce resources as between different lines of production. These budgets have to be coupled with industry studies, the so-called input-output matrix, and national income analysis, showing how it is produced, distributed, and spent on consumption, investment, or public expenditure. They have also to be coupled with a national income account, showing the

distribution of income as between the different social groups in the society.

Having made these surveys, plans for public expenditure, have then to be drawn up normally covering several successive years, five-year or ten-year plans. Some plans cover all public expenditure while others cover only public capital formation. In the process of drawing up the first of these plans, the several agencies of the government are compelled to look ahead, to re-examine their objectives and to determine their priorities. Such plans, however, have to include the proposals for all government agencies, including public undertakings. When these departmental plans are put together, the central planning authorities are enabled to relate them to each other, and further to set priorities in the light of the total amounts of money which are likely to be obtainable for public spending. There can then be formulated a well-balanced consistent plan, which enables the financial authorities to make their arrangements well in advance, and which sets the technical personnel precise tasks for a considerable period ahead. This is a great advantage both for the government which has its targets precisely formulated and for the people who get to know what the government is intending to do in the economic life of the society.

Once the plan has been drawn up, it has then to be put into operation, but in this respect it faces three problems. The first is drawing the line between the public sector and the private sector in the national economy. The problem seems to be largely a political

issue, but the government anyway has to assume special responsibility in so far as the private sector is concerned. In the field of industry, it can set up new industries publicly owned and administered for a certain period of time, and then sold or leased to private entrepreneurs on easy terms as a device to encourage businessmen to operate risky undertakings. Or, it may build up industrial centres so as to obtain, once and for all, the external economies and facilities available when many factory premises are grouped together in one centre. It can also finance technical training and establish industrial development banks in order to meet the danger that a large part of the new capital available for financing development will go to the public sector to the neglect of the private sector. Similarly, in the field of agriculture, it has an equally important part to play in providing capital for small farmers through farm credit institutions, in financing agricultural extension services, and in ensuring a sound agricultural organisation.

The second problem is what the government has to do to ensure that businesses in the private sector carry out that part of the development plan which is left to private enterprise. Two alternatives are open to the government: either to offer inducements, in the form of taxes and subsidies, to private enterprise so that it finds it most profitable to do what the plan really calls for; or to devise a system of licences, quotas and other direct controls, so that private enterprise is not free to do business in the most profitable way, but only in a way not inconsistent with the development plan.

The third problem is how to raise the new capital resources that are necessary for financing the planned development. In this respect, it is a natural tendency in under-developed countries to stress the importance of the external factors of development. The freer international movement of capital on reasonable terms and the facilitation of the general diffusion of the world's stock of technical knowledge and skills are major contributions which the more advanced countries of the world can make to the less advanced. They are contributions of the greatest importance. But they will not suffice. Without genuine co-operation from the countries to be benefited they will not be effective. Even if the utmost help from these external factors is given, the problem of economic development will not begin to have a practicable solution unless the under-developed countries dedicate their own resources, human, physical and financial, to a sound and persistent attack on those basic internal causes of mass poverty.

STATISTICAL APPENDIX

TABLE SHOWING CAPITAL REQUIRED BY UNDER-DEVELOPED AREAS IN INDUSTRY AND AGRICULTURE TO RAISE THEIR NATIONAL INCOME PER CAPITA BY 2 PER CENT ANNUALLY

1	2	3	4	5	6	7	8	9
Area	Population mid 1949 (millions)	Expected rate of annual population increase 1950-1960 (per cent)	National income 1949	Net domestic savings 1949	Industrialization : sation	Needed for Agriculture	Total needed	Deficit (Col. 8 minus Col. 5)
(million dollars)								
Latin America	158	2.25	24,000	1,990	1,580	960	2,540	550
Africa, excluding Egypt.....	178	1.25	13,200	720	1,780	528	2,308	1,588
Middle East, including Egypt	94	1.50	9,000	540	940	360	1,300	760
South Central Asia...	436	1.50	24,000	1,200	4,360	960	5,320	4,120
Far East, excluding Japan	661	0.75	26,400	790	6,610	1,056	7,666	6,876
Total	1,527	1.25	96,600	5,240	15,270	3,864	19,134	13,894

Source: United Nations, Measures For The Economic Development Of Under-Developed Countries, Report by a Group of Experts appointed by the Secretary-General of the United Nations, New York, May 1951, p. 76.

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